Risk Management

Self Funding Health Care

Susan Passmore, Executive Vice President

Blue Ridge Companies

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Navigating employee health care costs by going down the “self-funded” road.

When nothing goes right... Go left.

Calling a Time Out

Facing the facts:

- ✓ Under fully funded plans
    - ✓ Consistent premium increases
    - ✓ Benefit reductions
    - ✓ Regulatory environment
    - ✓ No understanding of plan utilization
- ✓ We have a high tolerance for risk
- ✓ Culture of interdependence

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Weighing the Options

Understanding self funding:

- ✓ Insurance advisor
- ✓ Third party administrator to manage the process
  - ✓ Acquire discount networks
  - ✓ Verify benefits
  - ✓ Process claims
- ✓ Less regulations and fees (3.5% less)
- ✓ Control of plan design and claims transparency
- ✓ Employer assumes 100% of the risk

Merge Carefully

- ✓ Evaluate impact based on the whole group; not individuals
- ✓ Have a capable and responsive administrator
    - ✓ Exposure to more detailed claims data; don't "personalize" it
    - ✓ HIPAA compliance is key
    - ✓ Ensure confidentiality and fairness
- ✓ Identify unique expense allocation and accounting procedures
    - ✓ Separate record to track claims and cash
    - ✓ Setup traditional premium structures
        - ✓ Employer paid portions (property reimbursed)
        - ✓ Employee paid portions
        - ✓ Cobra rates
        - ✓ Company on the hook for the difference!
- ✓ Understand the pitfalls of going back to fully funded

Avoid Confusion

- ✓ Be transparent with employees and owners
- ✓ Communicate early and often; know the “why”
- ✓ Address questions and concerns proactively
- ✓ Plan collateral/insurance cards need to be easy to read
  - ✓ Multiple parties represented
    - ✓ Third party administrator
    - ✓ Medical claims network
    - ✓ Rx claims network
    - ✓ Your company name
    - ✓ Highlight benefits verification info
- ✓ Continuous employee education
  - ✓ Empower them to educate providers
  - ✓ Employees need to question inconsistencies

Measuring Success

- Per (Plan) Member Per Month
  - $373 PMPM renewal with fully insured
  - $339 PMPM Y1 self-insured
  - $248 PMPM Y2 trended self-insured
- Y1 self-insured
  - Claims increased 21.5% from prior fully insured year
  - But saved 10% from fully insured=$150,000 and made no plan modifications
- Y2 self-insured
  - Fully insured PMPM would have headed to $425 vs $248
  - Allowed us to
    - Maintain/increase benefits
    - Less than $12 increase in EE paid portion over the last 6 years (value plan, employee only)
    - Headed toward significant Y2 total dollars savings

Stay the Course

- ✓ Be patient through both the good and bad years
- ✓ Be tolerant; have the financial wherewithal to ride it out
- ✓ Continue to improve benefits while limiting risks
  - ✓ Consider cost effective specific event coverage
  - ✓ Adjust stop loss coverage limits (consider captive for stop loss)
  - ✓ Don’t overlook Rx – adjust plan with pharmaceutical advancements
  - ✓ Cost management tools
    - ✓ Disease management
    - ✓ Wellness initiatives

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Risk Updates

Catastrophic Loss: Flood Risk

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Agenda

- CRIO Group: Introduction
- NFIP Update: Big Changes In The Works
- FEMA Remapping Programs
- Strategies to Increase Asset Values: Flood Zone Correction and Premium Reduction
- Property Insurance Marketplace: Trends and Private Market Alternatives

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CRIO Group at a Glance

- CRIO Group is a consortium of innovative insurance brokerage and risk management consulting companies:
  - ✓ Agency Flood Resources, Inc.
  - ✓ CRIO, Inc.
  - ✓ Flood Zone Correction, Inc.
  - ✓ Flood Risk Solutions, LLC
  - ✓ Premier Elevation Certificate Network, Inc.
- Over the last 15 years, CRIO Group has performed work for over 400 multifamily real estate companies nationwide

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NFIP Update: Big Changes in the Works

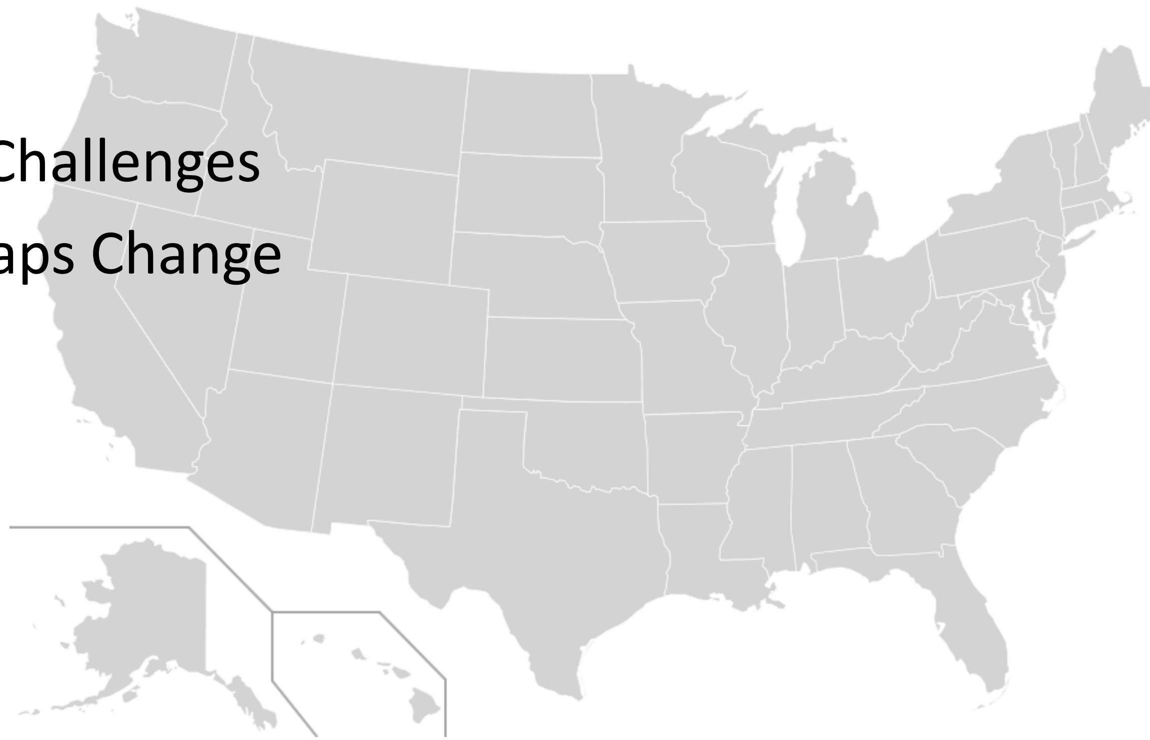
- The National Flood Insurance Program: A 3-Legged Stool
  - ✓ Risk Reduction: Floodplain Management, Building Codes, Regulations, Community Rating System (CRS) and Mitigation Grants
  - ✓ Risk Analysis: Flood Maps
  - ✓ Risk Insurance: Flood Insurance and Response & Recovery
- Nearly 5.2 million policies in force
- Roughly $1.25 trillion dollars of coverage in force
- Approximately $3.6 billion in premium annually
- About $5 billion in average annual losses last ten years
- 22,000 participating communities
- Multifamily represents 6% of the NFIP's policy base

Legislative Update: Rate Increases

- NFIP annual policy rate increase for any risk class 5% to 15% and 18% for any individual policy with some exceptions
- The following Pre-FIRM policy types will see 25% increases:
  - ✓ Business properties: Other Residential and Non-Residential
  - ✓ Non-Primary Residences
  - ✓ Severe Repetitive Loss Properties
  - ✓ Substantially damaged or improved building after FIRM adopted
- New surcharges will be added to all policies until all Pre-FIRM subsidies are eliminated
  - ✓ $25 for primary residences
  - ✓ $250 for all other policies
- Increased the Reserve Fund Assessment from 5% to 15%

FEMA’s Remapping Programs

- Map Modernization
- RiskMAP
- FEMA’s Remapping Challenges
- Why FEMA Flood Maps Change



FEMA's Remapping Programs

Map Modernization

- 2004 – Present
- Goal – Paper Maps to Digital Maps
- County-by-County
- Minor Changes – Primarily Account for Datum Shift

RiskMAP

- 2012 – Present
- Goal – Update Flood Insurance Studies
- Watershed-by-Watershed
- Major Changes – Changing Flood Zone Boundaries and Base Flood Elevations

Map Mod: In Progress vs. Completed

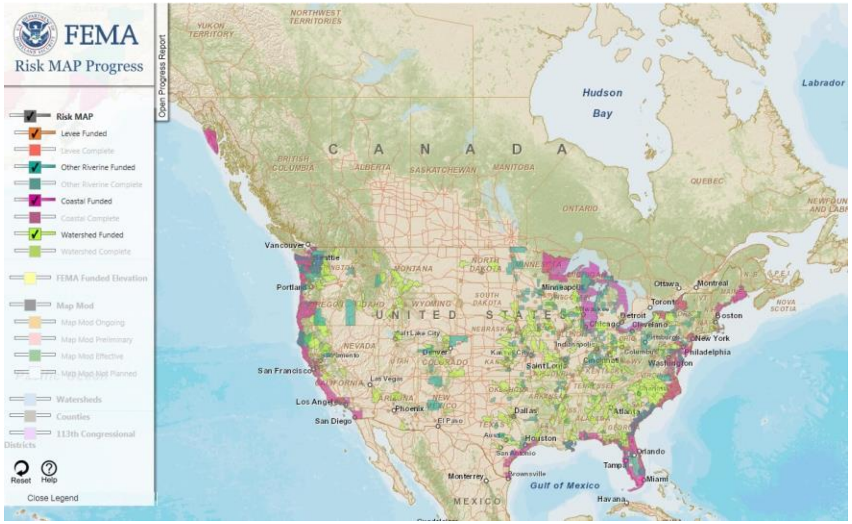
http://riskmapprogress.msc.fema.gov/

In Progress

Complete

RiskMAP: In Progress vs. Completed

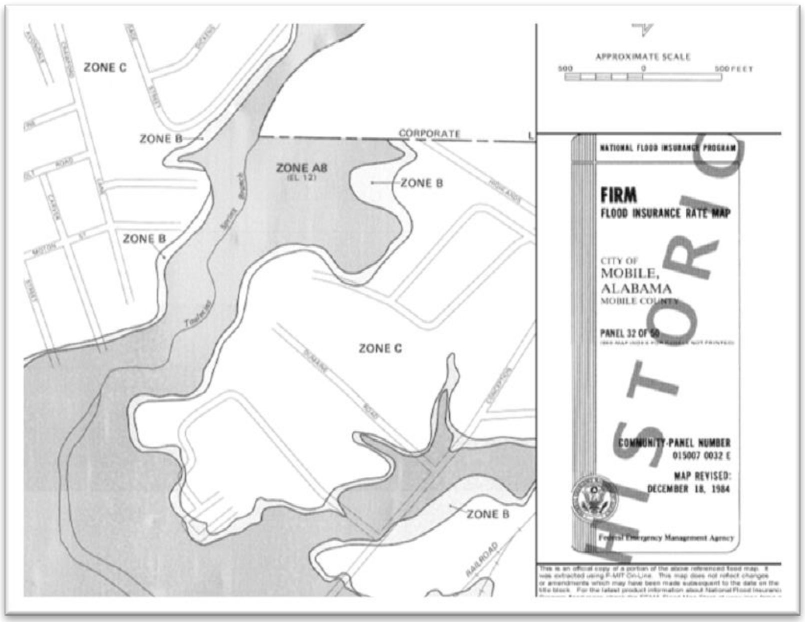
http://riskmapprogress.msc.fema.gov/



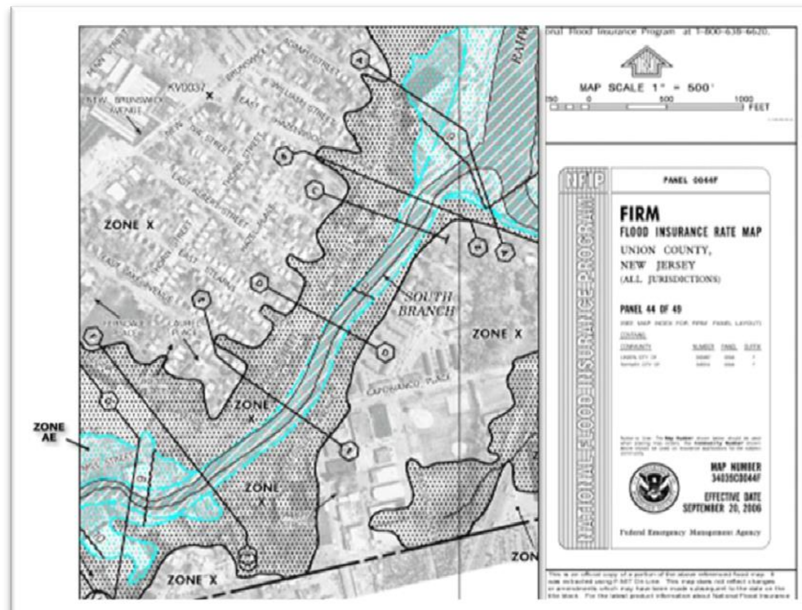
In Progress

Complete

FEMA’s Maps

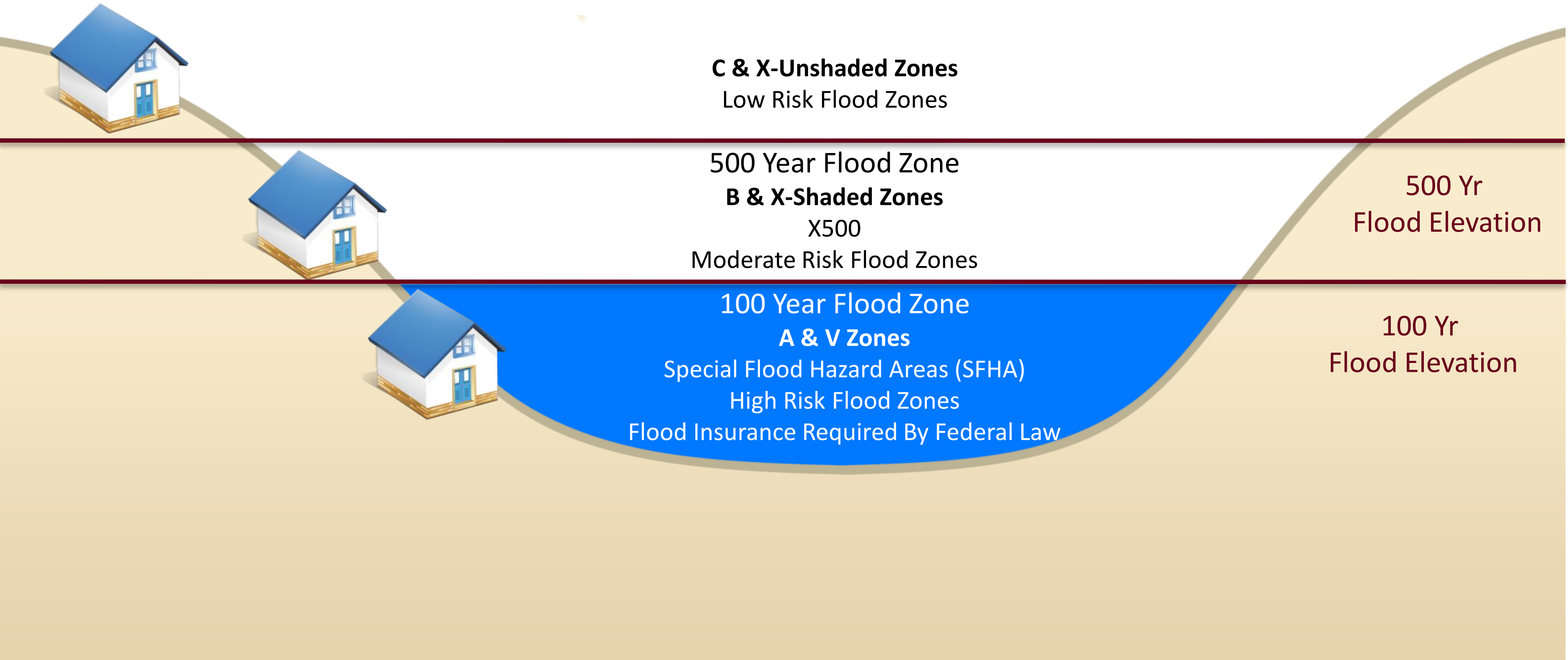


Old Maps: FIRM
Flood Insurance Rate Maps



New Maps: DFIRM
Digital Flood Insurance Rate Maps

Flood Zones



C & X-Unshaded Zones
Low Risk Flood Zones
500 Year Flood Zone
B & X-Shaded Zones
X500
Moderate Risk Flood Zones
500 Yr
Flood Elevation
100 Year Flood Zone
A & V Zones
Special Flood Hazard Areas (SFHA)
High Risk Flood Zones
Flood Insurance Required By Federal Law
100 Yr
Flood Elevation

Flood Zone Correction & Flood Map Revision

The goal is to utilize FEMA's flood zone reclassification programs to correct inaccurate flood zone designations or Flood Insurance Rate Maps (FIRM):

- Flood Zone Correction - FEMA's MT-1 Program:
  - ✓ Letters of Map Amendment (LOMA) and Letters of Map Revision – Based on Fill (LOMR-F)
  - ✓ Typical Time Frame: 30-90 days
  - ✓ Reclassify buildings based on comparison of building characteristics to FEMA's existing FIRM
- Flood Map Revision - FEMA's MT-2 Program:
  - ✓ Letters of Map Revision (LOMR)
  - ✓ Typical Time Frame: 90-180 days
  - ✓ Revise FEMA's Flood Insurance Study (FIS) and the corresponding FIRM to change flood zone boundaries and/or base flood elevations

Bottom Line:
Eliminates federal flood insurance requirement, often improves coverage and increases or protects asset values.

Benefits of Correcting Flood Maps

Successful flood zone correction delivers valuable benefits:

- Corrects erroneous flood zone classifications
- Eliminates unwarranted flood insurance requirements imposed by lenders
- Maximizes flood coverage afforded under a master property insurance policy
- Eliminates unnecessary NFIP policies and the associated premiums
- Increases NOI and, therefore, asset values
- Improves marketability of properties for sale

Flood Zone Correction: Case Study

The Challenge

A large real estate asset management and advisory company with 16 multifamily properties in its portfolio that standard flood zone determinations indicated to be within FEMA-designated Special Flood Hazard Areas (SFHA), which include flood zones beginning with letters A or V.

Number of SFHA Multifamily Properties: 16
Cost of Annual Premiums: $136,045

The Solution

We performed a thorough flood risk analysis on 13 properties and found that 11 properties were not at high risk of flooding during catastrophic rainstorms. We worked with FEMA to successfully remove the 11 properties from the high-risk flood zone and to reclassify them into a low-risk flood zone.

The Savings

Properties Removed out of the SFHA
11 out of 16
while maintaining the exact same coverage

Premiums Eliminated
$103,309 (76%)

Premium Reduction

The goal is to identify a less expensive way to rate the NFIP policy to deliver annual savings on the NFIP policy:

- Applies to buildings that are correctly classified in SFHA
- Requires extensive knowledge of NFIP underwriting rules
- BW12 began to phase out these opportunities
- HFIAA brought these opportunities back into play

Premium Reduction: Case Study

The Challenge

A multifamily real estate company with a large apartment complex portfolio, where the NFIP flood insurance premiums were $222,434 for 29 flood insurance policies. The high cost of flood insurance resulted in the property operating with a negative cash flow for several years, which substantially decreased the value of the property. The client desperately sought a solution that would decrease its flood insurance costs while allowing it to maintain the same coverage in order to satisfy its lender's flood insurance requirement.

The Solution

We used our research-driven underwriting process to procure data and re-rated the flood policies using an alternative rate structure available through the NFIP.

The Results

Reduced annual insurance premiums by
$167,956 (75%)
while maintaining the same coverage

Increased property values by
$2.4 million*

* Based on the application of a 7% capitalization rate to the amount of annual savings.

Produced insurance refund of
$295,280

Property Insurance Marketplace: Flood Trends

- Changing flood deductible language
- Decreasing flood sub-limits
- Increasing rates
- Creating more geographic restrictions

Bottom Line:
Pay close attention at renewal

Property Policy Flood Deductibles

- Most common flood deductibles for A and V zones are:
  - ✓ Maximum limits available through NFIP per building, whether purchased or not
  - ✓ A fixed dollar amount per occurrence, such as $250,000, $500,000 or $1,000,000
  - ✓ 5% of location or affected TIV per occurrence, subject to $500,000 or $1,000,000 minimum
- Most common flood deductible applicable to X-unshaded and C zones is the insured’s AOP deductible
- Flood deductibles for X-shaded, X-500 and B zones can be AOP deductible, same as A and V zone deductible, or somewhere in between

Private Market Flood Programs: Trends

- Several private market programs available for:
  - ✓ Condominium buildings
  - ✓ Commercial buildings
  - ✓ Single family homes
- Private market policy forms:
  - ✓ Most policy forms mirror NFIP policy terms
  - ✓ Some policy forms offer broader coverage than NFIP
  - ✓ Can be one policy per building, or per location, or for a schedule of locations
- Private market risk appetite:
  - ✓ Most programs cherry pick low risk buildings at a cost below NFIP
  - ✓ Other programs pick high risk buildings at a cost above NFIP
- Private market limits:
  - ✓ Some programs match NFIP limits per building
  - ✓ Other programs have limits up to $20 million per location

Comparison: NFIP vs. AFR Flood Program

NFIP Coverage	AFR Flood Program
Separate policy for each building	One master policy for all buildings
Scattered renewal dates	One renewal date
Effective/renewal date set based upon loan closing date	Effective/renewal date set based upon insured's choice
Actual Cash Value (ACV) coverage	Replacement cost value (RCV) coverage
Policy limits may not match the A and V Zone flood deductible	Per occurrence limit matches the A and V Zone flood deductible
Possible coverage gap	No coverage gap
No business interruption or loss of rents coverage	Business interruption/loss of rents can be included

Bottom Line: AFR Flood Program simplifies administration, eliminates gaps, improves coverage at approximately the same cost as NFIP coverage.

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Thank You

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Which Is Right for You?

The Changing Landscape of Renter's Liability Insurance

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Please note this presentation is not intended to present financial, legal or insurance advice. It expresses the independent views of the presenter only as a topic of discussion.

Renter Insurance and Liability Options

Options now exist to allow owners and managers to choose solutions with varying degrees of coverage and income. Three programs for discussion today include:

- Third Party Insurance vendors (most common)
- Insurance Indemnity Program
- Landlord Legal Liability Program
- Captive Insurance Program

Standard 3rd Party Renters Insurance

<u>Standard Renters Insurance and Liability Coverage</u>

- Renters are required to carry liability insurance that protects the owner in the event of resident negligence
- Resident pays insurance company directly at average cost of $15 to $25 per month
- Management companies may partner with insurance vendors allowing them to provide collateral materials at the community with a minimal advertising fee paid to the community
- Communities may receive a fee for advertising space that could run as high as $6 to $8 PUPY
- Liability coverage is provided through the insurance company. Reimbursement for damages caused by resident negligence is made through the insurance company on behalf of resident
- Resident's must opt to insure their personal belongings at additional cost

Renter's Indemnity Program

<u>Low Cost to Resident, No Insurance Coverage</u>

- Program is a self managed *risk program*. It is not an insurance program and provides no insurance for property or resident
- Essentially allows the resident to "Opt-Out" of carrying liability insurance and releases the resident from the indemnity up to the property deductible amount for damages related to fire, water or smoke damage
- Cost to resident is $8 PUPM
- Cost for administration of the program by 3rd party runs $2 PUPM leaving $6 PUPM as income to site or to be placed in a common account
- Common account can be held in a single account and might be used to reimburse property for deductible when claims from negligence occurs
- Opt-out model charges fee at move-in. Resident has 30 days to bring proof of liability coverage elsewhere which will remove the $8 monthly charge from resident
- Always check with legal counsel before offering programs of this nature

Fully-Insured Landlord Legal Liability Program

Low Cost to Resident – Master forced placement policy

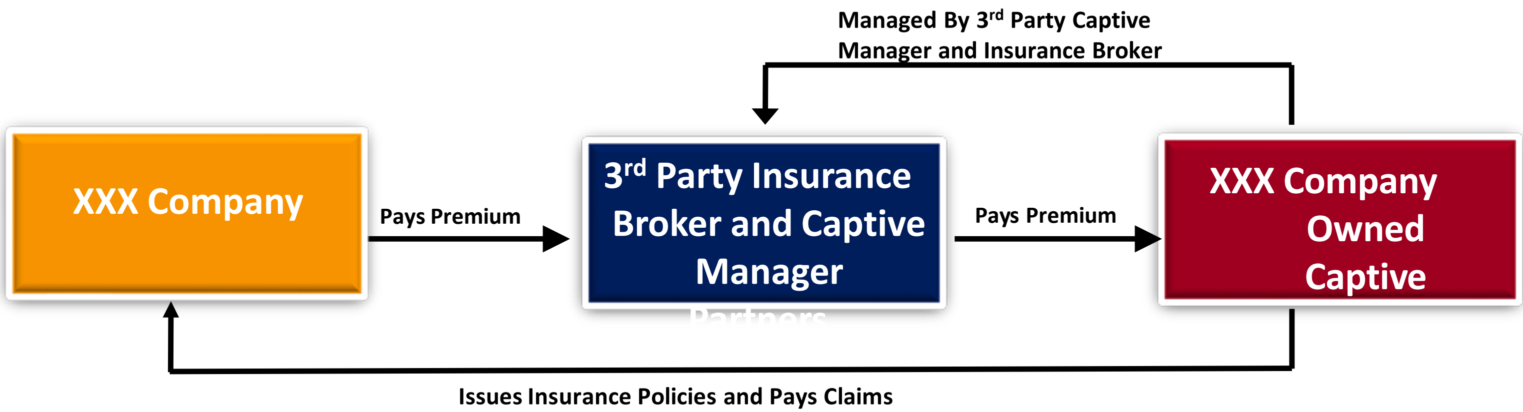
- A master forced-placed liability only program in which the management company secure renter liability coverage for residents and passes a reduced cost through to the resident
- Assumed cost to resident is $10 PUPM paid to the property
- Sample cost for providing liability insurance of opt-in residents by 3rd party would run $6 PUPM, leaving $4 PUPM as ancillary income for the property
- Above option would be provided to residents for liability coverage as an enforcement of their lease onto those opting in
- Resident's securing personal coverage elsewhere would not pay this $10 PUPM fee to the property
- Resident belongings are not typically covered if this choice was selected

Captive Insurance Program

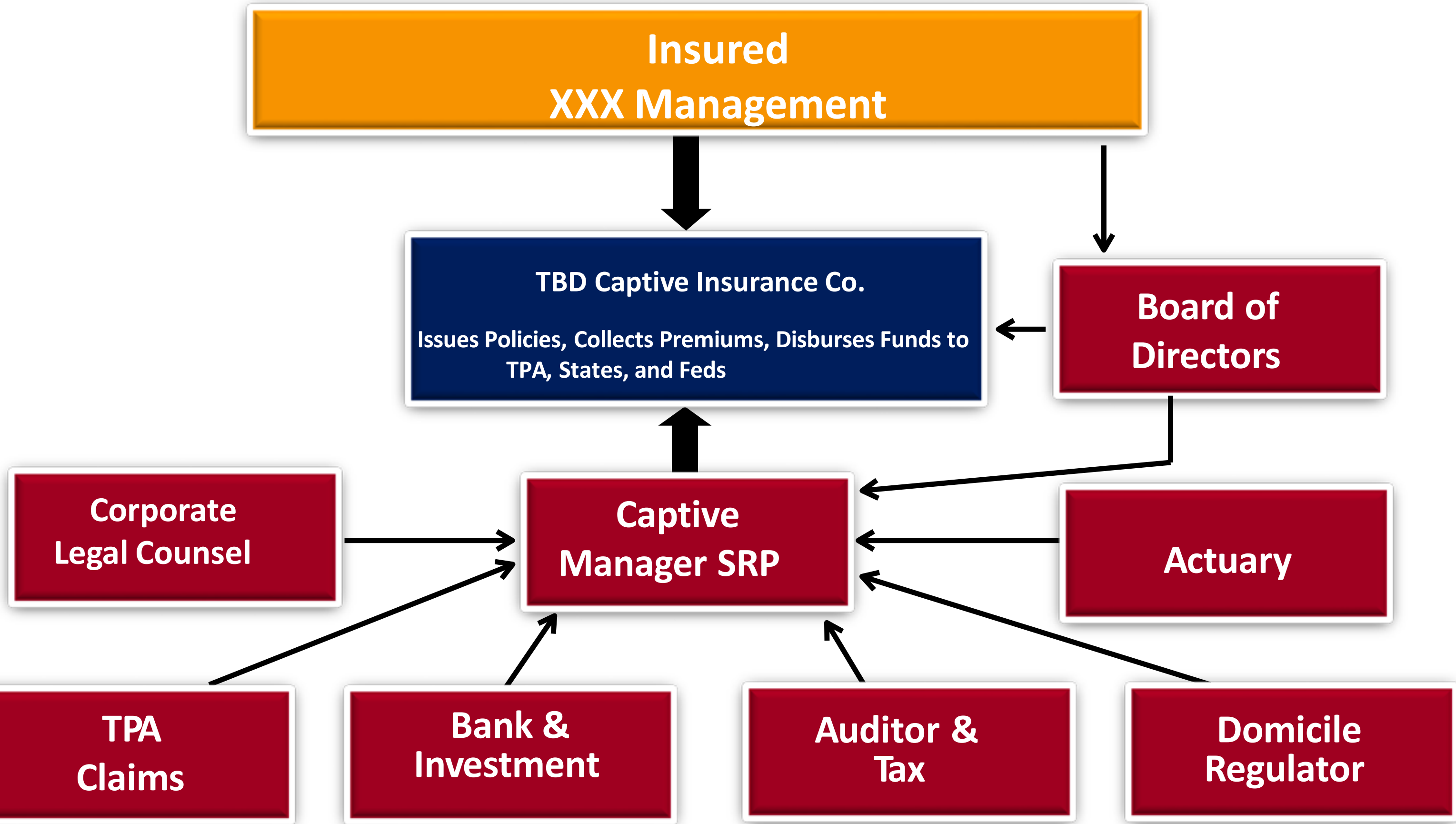
Private Insurance That Insures Risk(s) Of Owners Or Affiliated Third Party

- A captive is a sophisticated method of self-insurance
  - Offers liability coverage to residents through 3rd party insurance company owned by management company
  - May be customized to provide small amount of coverage for personal property of residents not at fault and in alignment with covered perils
- Up to $1.2M of net premiums annually = no taxes on operating profits. Taxes will be due on investment income. If you have a captive above 1.2M you would pay taxes on entire amount.
- Customizable; owner/risk management/finance team involved in plan design
- Requires long-term commitment and up-front financial capital
- Internal administration is limited and captives require a licensed captive manager to handle regulatory requirements
- Typically runs $10 PUPM to resident and paid to property
- Captive may be used to fund specific company risk and responsibility cost like worker's comp, insurance deductibles, etc. and may be an active profit center
- Captures the underwriting profit currently going to the typical insurance carrier
- NOTE: Involvement of legal and licensed captive manager is necessary with this program

Hypothetical Directly Written Captive Structure



Typical Structure



Captive Benefits

- Coverage can be tailored to meet the specific needs of the policyholder(s)
- Underwriting flexibility to provide coverage where it is unavailable or overpriced in the commercial marketplace
- Premiums are based on the loss experience of the captive, not on the income and expense needs of an insurance company
- Cost Savings- elimination of insurance carrier expenses
- Premium funding flexibility based on actuarial loss projections via confidence intervals
- Underwriting profit & investment income belongs to the captive, not the traditional insurance company
- Accumulated surplus can be used to reduce future premiums or be returned to the policy holders as dividends
- Potential tax benefits; More incentives for safety, loss prevention, loss control

20,000 Units – 4 Options

		Typical 3rd Party Program	Indemnity Program	Landlord Legal Liability	Captive Program
Assume 20,000 units		20,000 units	20,000 units	20,000 units	20,000 units
Assume Penetration of 70%		14,000 units	14,000 units	14,000 units	14,000 units
INCOME					
PUPM Paid by Resident (estimated)		$ 25 monthly	$ 8 monthly	$ 10 monthly	$ 10 monthly
Paid to Community		NO	YES	YES	YES
Annual Per Unit received by property for payment of policy		$0	$ 96 PUPY	$ 120 PUPY	$ 120 PUPY
Annual $$$ collected at site (70%)		$0	$1,344,000	$1,680,000	$1,680,000
Marketing fee paid to site - Assume $6 Per Unit Annually		$130,000	$0	$0	$0
TOTAL INCOME TO COMMUNITIES		$130,000	$1,344,000	$1,680,000	$1,680,000
EXPENSES					
Liability cost PUPY paid by property		n/a	n/a	$ 72 PUPY	n/a
Total Annual Cost to Property for resident liability coverage (to 3rd party)		n/a	n/a	$1,000,000	n/a
Annual administrative cost paid to Insurance Broker for running of program		n/a	$2 PUPM/ $24 PUPY $ 336,000	n/a	8% - $ 134,400
Additional Administration cost (estimated 3rd party) Audit, Tax Prep, Captive program		n/a	n/a	n/a	$100,000
TOTAL EXPENSE COST OF PROGRAM		$0	$336,000	$1,000,000	$234,400
Average Estimated Losses			15% $250,000		15% $250,000
NET INCOME (+ or -)		**$130,000**	**$ 758,000**	**$ 680,000**	**$1,195,600**
Claims caused by Resident Negligence		**Resident's insurance carrier pays claim;**	**No liability insurance but funds can be used to reimburse site for deductible**	**Insurance carrier pays claim. Remaining funds can be used by site or management company**	**Captive Insurance carrier pays claims. Remaining funds can be used by site or management company**

Thank You

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