



January 20, 2010

Dear CIAW Associate Member:

Recently we received a directive from Shannon Stuber, at the Office of Financial Management (OFM) related to the method in which CIAW accounted for estimated claims liability. It is important for you to realize that her directive is narrowly focused on accounting practices related to creating a reserve for estimated claims liability and does not affect the financial soundness of our program or the current operations.

Ms. Stuber issued out this directive as a "Cease and Desist Order." While the name sounds ominous, it is merely a directive that requires us to review the problem and work with her to come up with a solution. RCW 48.62.091 gives the state risk manager the authority to issue out a "Cease and Desist Order" for any claimed violation of RCW 48.62. Risk Managers in the past have not elected to use this authority but have simply worked closely with the pool to correct potential problems. Ms. Stuber has not demonstrated a willingness to follow this cooperative model. In fact, there was not even a regulation to authorize use of this power until Ms. Stuber promulgated one recently. Her proposed regulation became effective on January 14, 2010, and Ms. Stuber issued out this "Cease and Desist Order" just hours after that WAC was approved.

It is important to note that this "Cease and Desist Order" does not, in any manner, interfere with the CIAW's right to continue its operations. This is merely a method for the risk manager to notify a pool of a claimed violation of some provision of RCW 48.62. If the pool does not comply with the recommendations of the "Cease and Desist Order" then the OFM can refer the matter to the State Auditor and/or the Attorney General for a further review. While the Board believes that this Order was "heavy handed" it will comply with her directives and make every effort to resolve this dispute with the state risk manager on mutually agreeable terms.

We were quite surprised to receive this Order, since we had been working on this issue with Ms. Stuber for several months to correct this accounting problem and she never once indicated to the Board that this was a concern that would result in such drastic action. She was at our Board meeting on November 30, 2009, and left us with the impression that we were working successfully with her office in resolving this matter.

The "Order" does not affect our right to continue to operate successfully and provide risk management services to our members. It only requires us to change our accounting methods and set up a plan to ensure that we have sufficient reserves in the future to cover potential losses that might develop arising from operations during 2003-2006.

We understand that our competitors are trying to take advantage of this concern by overstating the true effect of this accounting issue and the actual authority of the Order. The Board wants you to understand the true facts to counter any rumors related to this issue.

THE PROBLEM

During the operation years 2003-2006, CIAW was operating with an aggregate "Stop Loss." What this means is that any liability of the CIAW above the stop loss "attachment" point, is covered by an additional insurance policy that CIAW purchased from our excess carrier. The CIAW, with the assistance of our Third Party Administrator Canfield & Associates, would then adjust any claims in our Self Insured Retention (SIR). In other words, since the CIAW has an SIR of \$100,000 it would be responsible for paying the claim up to that amount. The excess carrier would cover the rest. If the combination of all possible claims within the SIR exceeded a certain collective amount, then our aggregate "Stop Loss" insurance would cover any potential losses above that "attachment point." This is the safest method of risk pool operation and sets us apart from our competitors.

During the years 2003-2006, CIAW decided that it was not necessary to fund the entire potential exposure up to the stop loss. This decision resulted in lowering the premium charged to our members during those years. The Board sought the advice of an actuary to determine the safest level that we could fund regarding our future losses. At the time, the Board believed that this funding method was financially sound and complied with all existing regulations. The State Auditor carefully reviewed our records during each of these years and did not express any concern about our funding method. (During that time, Ms. Stuber was on the auditing team that reviewed our records.)

Recently, as the new OFM Program Administrator, Ms. Stuber was changing many of the regulations related to how pools could operate. The rules related to stop loss funding were changed. This caused us to reevaluate our stop loss funding during 2003-2006. We determined that our funding during those years was probably understated. We were working closely with the Risk Manager on how to resolve this accounting issue. She advised us that we could recoup the shortfall over a three to five year period. We then instituted a plan to recover the entire shortfall over the next five years. We also agreed to have an out-of-state auditor hired by Ms. Stuber review our records for those years to make sure we were funding at the proper amounts. The out-of-state auditor generally agreed with the amount that we determined was necessary to have in the future to cover any estimated claims liability. The auditor recommended to Ms. Stuber that CIAW develop a plan to collect the necessary reserves in the future. CIAW had submitted a proposed plan to Ms. Stuber.

The auditor also made some suggestions about other changes in our accounting system that are not subject to Ms. Stuber's Order, but may be helpful for us in the future. Despite the fact that we were fully cooperating with the State to resolve this matter, Ms. Stuber unexpectedly issued out the "Cease and Desist Order" without any warning to us. She issued the Order on a Friday afternoon of a three-day weekend. We were quite frustrated by her actions, which were clearly unnecessary under the circumstances.

THE SOLUTION

The Board has been working on an acceptable solution for some time. We had what we thought was an acceptable recoupment plan in effect when we received this rather provocative Order. Ms. Stuber has asked us, in her Order, to submit a different plan by January 25, 2010, and we will comply with her request. She has also set a meeting for January 29, 2010, to explain to us why she issued out the Order in the first place. This

seems odd to the Board and we wonder why she did not pay us the courtesy of explaining her intentions before issuing out this Order and give us a chance to resolve the matter in advance of her taking such drastic action.

We will be hiring an independent outside auditor to review the situation and advise us on an acceptable plan to build up our reserves over the next five years to cover any potential future losses. Methods within the plan may include coverage review, third party administrator fees, excess carrier costs and program structure. In the interim, the Board is intending to adopt a resolution that will formally obligate the CIAW to collect these additional reserve amounts over the next five years. We changed our reserve funding method after 2006 and the State has no objection to our present system. The plan we are implementing only affects the years 2003-2006. We believe that this resolution will comply sufficiently with Ms. Stuber's directive.

The Board wants to apologize to members regarding this matter and any inconvenience that it may cause. At the time the problem developed, the Board was acting in good faith and honestly believed that its reserve funding was adequate. As the rules changed, the Board then realized that it had to adjust its reserve funding for the years in question and was working successfully to do that when Ms. Stuber issued out her order. Rest assured that this issue will not affect the day-to-day operation of CIAW and we will continue to provide each of you with competitive and comprehensive Risk Management protection now and in the future.

You, as an associate member of our pool, are also encouraged to participate in this process. Please consider attending any of the upcoming Board meetings—or again—simply contact the Board or the staff at Canfield with any questions you may have.

Since 1988 we have owned and operated our pool in a safe, sound, and successful manner. This challenge from Ms. Stuber will not alter that practice. As a Board, we know that our pool will emerge from this regulatory dispute stronger and more capable than ever before.

On behalf of the Board of Directors,



Wes Crago, Chairman

cc: CIAW Agents and Brokers