



**JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION**  
**Fiscal Impact Review**  
**2013 Session**

**Bill Number:** SB 1091

**Review Requested By:** Senator Stosch

### **JLARC Staff Fiscal Estimates**

SB 1091 would grant local governing bodies in Virginia the authority to opt out of the State's liability insurance program for constitutional officers, their employees, and regional jail staff. The Department of Treasury's Division of Risk Management administers the liability insurance program called "VaRisk," that covers over 16,500 individuals. The bill specifies that localities that leave VaRisk would not be required to pay premiums or to contribute to administrative costs. However, SB 1091 does not mandate that localities that leave purchase comparable coverage, and it is assumed that every locality would still insure their constitutional officers and staff through other means. Failure to insure such personnel would expose the locality to potentially significant and variable costs.

The fiscal impact of SB 1091 could total \$3.1 million per year or more for the state, depending on the number of localities that elect to leave, the level of comparable coverage they purchase (if they purchase alternative coverage at all), and whether such coverage includes the costs of legal defense. Currently, the Division of Risk Management spends on average \$3.1 million per year for defense counsel costs, and per §15.2-1606 of the Code of Virginia, the State Compensation Board would be required to reimburse localities for these legal expenses. Localities would assume losses associated with claims, which could be significant, depending on the comprehensiveness of their private coverage. The state could also be responsible for \$23.6 million—the estimated cost of active and future claims as of July 2013—unless localities pay these costs prior to exiting. Indirect costs would impact officers who remain in the state's insurance pool, but these costs are difficult to estimate without an actuarial analysis of various cost scenarios.

Because of the unknowns that remain, JLARC staff concur with the Fiscal Impact Statement's estimated cost to the state of \$2.46 million per year in potential defense counsel costs. However, costs have continued to escalate since that estimate was made, and the average legal cost has risen to \$3.1 million. There could be an additional \$23.6 million in active and future claims costs.

An explanation of the JLARC staff review is included on the following pages.

**Authorized for Release:**

**Hal E. Greer**  
**Director**

**Bill Summary:** SB 1091 would grant local governing bodies in Virginia the authority to opt out of the state's liability insurance program for constitutional officers, their employees, and regional jail staff. Under current statutes, the State Compensation Board decides whether these individuals participate in the program administered by the Treasury's Division of Risk Management (DRM) and has chosen such coverage. The bill specifies that localities leaving the state's insurance program would not be responsible for paying premiums or for contributing to administrative costs related to the program. The bill does not mandate that localities purchase alternative insurance policies if they exit. It is unknown how many localities would choose to leave the state's insurance plan if provided the option.

**Discussion of Fiscal Implications:** Since 1987, constitutional officers have been covered by DRM's insurance program, VaRisk, which includes general liability, law enforcement liability, and errors and omissions liability. Today, 16,522 individuals are covered by VaRisk, including approximately 650 constitutional officers, their staff, and regional jail staff. Because the Compensation Board decides participation, all officers and staff are currently covered by public insurance, although the Code of Virginia does not prohibit localities from purchasing supplemental private coverage (it is unknown how many have elected to do so). According to DRM, the quality and extensiveness of coverage has changed little since VaRisk began in the late 1980's. Compensation Board staff also report no major concerns from localities regarding the quality of coverage. Over the last three years, the Compensation Board estimates spending \$30,000 per year on defense counsel for occurrences not covered by VaRisk.

*Total Premiums More Than Doubled Beginning FY 2014*

Insurance premiums have totaled \$3.1 million annually for most of the last decade but dropped to \$2.8 million in FY 2011 through FY 2013. Traditionally, the Compensation Board allocated general funds to fully cover premiums, but due to declines in appropriations, the Compensation Board paid only 50% of premiums from FY 2009 to FY 2011, and beginning in FY 2012, localities assumed the full cost of coverage. A significant change in premium rates took effect for FY 2014, in which total premiums more than doubled to \$6.6 million, increasing the average rate per individual 137%, from \$169 to \$401 per year. Because premiums vary by the category of officer, the table below shows the average premium rate per category before and after the FY 2014 rate increase. In particular, sheriffs and regional jail staff saw their premiums rise 547%, and they pay more than other officers due to the number of individuals covered. Commonwealth attorneys' rates also increased; however, rates for all remaining officers declined.

Category of Officer*	Number of individuals	Contribution Percentage	Average Annual Premium Rate Per Person FY 13	Average Annual Premium Rate Per Person FY 14	Percent Change from FY 13 to FY 14
Clerks	1,237	7%	\$445	\$193	(57)%
Commissioners of the Revenue	846	5	302	75	(75)
Commonwealth Attorneys	1,264	8	230	315	37
Regional Jails & Sheriffs	11,935	72	76	489	547
Treasurers & Finance Directors	1,240	8	640	65	(90)
<b>Average</b>	---	---	<b>\$169</b>	<b>\$401</b>	<b>137%</b>
<b>Total</b>	<b>16,522</b>	<b>100%</b>	<b>\$2,791,800</b>	<b>\$6,616,688</b>	<b>\$3,824,888</b>

\*Includes staff.

Note: Numbers may not add due to rounding.

DRM suggests that the doubling of premiums is the result of greater losses and legal fees. To a lesser extent, the passage of HB 1554 during the 2013 General Assembly also affected the rate increase. This legislation raised the liability limit for sheriffs from \$1 million to \$1.5 million.

### *Managing an Inconsistent Insurance Pool Would Be a Challenge*

The wording of SB 1091 does not fully convey the complexities and potential costs of permitting an unknown number of individuals to exit DRM's insurance pool. For instance, the bill does not address whether localities could exit and later reenter the state's insurance program, and if so, under what conditions. With over 150 local governing bodies in Virginia (i.e., city councils, county boards of supervisors, and regional jail authorities), DRM's ability to manage frequent changes in participation (and subsequently, the risk pool) is questionable. If restrictions were placed on exit and reentry, it might be possible for DRM to manage the pool; however, administrative and program costs would likely increase. Currently, DRM has 13 full-time employees and allocates \$1.5 million toward program and administrative expenses for the Constitutional Officer program.

### *Three Costs Associated with SB 1091*

JLARC staff identified three types of costs related to SB 1091: transition costs, ongoing costs, and indirect costs. Some of these costs affect the state while others affect localities.

#### (1) Transition Costs Must Be Distributed Prior to Exit

A problem in estimating costs to the state is how to distribute future costs among those exiting the pool. According to DRM's 2013 actuarial analysis, \$23.6 million (updated from the Fiscal Impact Statement's total of \$15 million) must be on reserve for the payment of active claims, claims that will be reported by the end of the fiscal year, and claims that have been incurred but not yet reported (this figure includes indemnification costs as well as defense counsel expenses). Because claims can take years to resolve, DRM would need to distribute a portion of these future expenses among localities that elect to leave the pool. If DRM does not distribute these costs among those leaving the state's insurance plan, then either individuals remaining in the pool would face higher rates, or DRM would require additional funds.

#### (2) Ongoing Costs Could Impact the Compensation Board's Budget and Localities' Budgets

Beyond one-time costs related to transitioning from public to private insurance, it is important to address SB 1091's potential fiscal impact to the State Compensation Board and localities. Although it is likely that many localities choosing to leave VaRisk would seek alternative insurance coverage, it cannot be assumed that every locality would do so. Compensation Board staff suggest that in some areas of the state, officers might go uninsured or underinsured due to the cost of policies. As a result, constitutional officers may have varying degrees of coverage across the state.

In accordance with the Code of Virginia (§15.2-1606), the Compensation Board is required to reimburse localities for "any expenses incurred in the defense of such a charge," with "charge" referring to claims not covered by DRM's plan. Currently, the Compensation Board pays 100% of defense costs, with the exception that it pays only 50% of costs for treasurers and commissioners of the revenue. If localities do not insure their officers or if they provide inadequate coverage which does not include defense counsel, the Compensation Board could pay an estimated \$3.1 million per year or more in legal costs. This figure represents the amount DRM paid on average over the last five years to defend claims. If additional general funds are not allocated to account for these costs, the budgets of constitutional officers could be impacted.

Localities electing to leave the VaRisk program would be responsible for paying full indemnification costs. Without comparable coverage (or potentially no coverage), indemnification costs could be significant. In terms of the availability of comparable coverage, JLARC staff were not able to obtain information pertaining to private insurance policies. To the knowledge of Treasury and the Compensation Board, there have been no prior cost comparisons. This presents a major limitation in estimating potential costs.

To provide a snapshot of potential indemnification costs to localities as well as defense counsel costs to the State Compensation Board, the table below indicates the average cost of all claims since the inception of the program in 1987 (columns 2 and 3), the most expensive claim categories (column 4), and the total costs of those claims (column 5). Regional jails and sheriffs are subject to the most risk and therefore have the highest average costs compared to other categories of officers.

Category of Officer*	Average Defense Counsel Costs Per Claim	Average Indemnity Costs Per Claim	Most Expensive Claims Categories (includes defense costs and indemnification)	Total Cost of Claims Categories
Clerks	\$6,145	\$12,525	(i) Defamation (ii) Record keeping (iii) Services not provided	(i) \$412,161 (ii) \$337,577 (iii) \$270,710
Commissioners of the Revenue	\$7,518	\$27,333	(i) Employment (ii) Property rights (iii) Record keeping	(i) \$361,751 (ii) \$176,402 (iii) \$44,930
Commonwealth Attorneys	\$5,573	\$15,000	(i) Malicious prosecution (ii) Defamation (iii) Employment	(i) \$350,848 (ii) \$295,697 (iii) \$253,752
Regional Jails	\$15,602	\$81,269	(i) Assault-guard v. inmate (ii) Use of force (iii) Medical	(i) \$2,663,608 (ii) \$2,393,578 (iii) \$2,225,943
Sheriffs	\$8,112	\$33,856	(i) Use of force (ii) Employment (iii) Failure to protect	(i) \$7,273,311 (ii) \$6,726,128 (iii) \$5,918,594
Treasurers	\$6,204	\$32,205	(i) Employment (ii) Services not provided (iii) Record keeping	(i) \$293,810 (ii) \$140,922 (iii) \$110,867
<b>Overall Average</b>	<b>\$9,112</b>	<b>\$39,700</b>	---	---

\*Includes staff.

Note: All averages and totals are over a 27-year period. Not adjusted for inflation.

### (3) Indirect Costs Are Indeterminate

Indirect costs would fall on the remaining participants in the insurance pool if local governing boards elect to leave the VaRisk program. These costs could be in the form of higher premiums or less coverage. Not only does the number of localities exiting matter, but also the type of officer exiting. Because law enforcement policy holders are responsible for a majority of premium revenue, if higher risk sheriffs and regional jail staff remain with the state program and lower risk individuals exit, then premiums could rise to the extent that public insurance may no longer be affordable.

#### *Total Cost to the State Could Exceed \$3.1 Million per Year*

At this time, the fiscal impact of SB 1091 to the state is largely speculative but could be improved with an actuarial analysis of cost scenarios. Several unknowns remain, such as the number of localities that would elect to leave, the resulting changes in risk levels for the state's insurance pool, and the cost and quality of private coverage. JLARC estimates that the Compensation Board could pay \$3.1 million per year in defense counsel costs, assuming all localities purchase

comparable coverage (excluding defense counsel) and agree to cover transition costs. If localities do not pay for transition costs, the state would need to cover \$23.6 million in active and future claims. Localities would be required to pay full indemnification costs, which cannot be estimated at this time.

**Budget Amendment Necessary:** Yes.

**Agencies Affected.** State Compensation Board, Department of the Treasury, Division of Risk Management, local governing boards.

**Date Released, Prepared By:** 11-1-2013. Liana Kleeman.