TML RISK MANAGEMENT POOL
BOARD OF DIRECTORS REGULAR MEETING
DATE OF MEETING: NOVEMBER 22, 2013
BRENTWOOD, TENNESSEE

The Board of Directors of the TML Risk Management Pool ("The Pool") met at 8:45 a.m. on November 22, 2013 at the Pool's office in Brentwood, Tennessee in its regular meeting.

Board Members present included: Chair Tommy Green, Vice-Chair Sam Tharpe, Curtis Hayes, Pete Peterson, Tom Rowland, Kay Senter, and Ken Wilber. Allen Barker who had been an Ex-Officio Board member as President of the Tennessee Municipal League ("TML") tendered his resignation to TML on November 21, 2013 and, consequently, was not present.

The Pool's staff present were: Dawn R. Crawford, President/CEO and Charles DeMore, Executive Vice President & Chief Financial Officer.

Also present were Russ Farrar, General Counsel; Margaret Mahery, Executive Director, TML; and, Charles "Bones" Seivers, President, TML Bond Fund; and, Mark Blackburn with Lattimore, Black, Morgan and Cain, P.C.

1. APPROVAL OF MINUTES

Motion was made by Rowland to approve the minutes of the September 13, 2013 Board meeting; seconded by Wilber. PASSED UNANIMOUSLY

2. CAPITAL MODELING STUDY

President Dawn Crawford introduced Kevin Wick with PricewaterhouseCoopers who joined the meeting via audio/video connection from Seattle, Washington to present the preliminary results of a capital modeling study. Crawford noted that the purpose of this study was to provide an independent professional review of the Pool's capital adequacy. Wick presented an overview of the risk management process applied in the study and the assumptions used, including the various risk categories of capital need. Peterson asked about an insurance industry's suggested rating range of between 1-in-100 and 1-in-250. Wick explained that while that range is common for regulated commercial carriers, such carriers have options available to them that risk pools do not, such as canceling a block of policies if the carriers determine they are under-capitalized. Wick emphasized that it is important for the Pool to define its risk profile and funding range. Because the presentation of the preliminary results was informational only, no Board action was necessary.

3. AUDIT REPORT

Chairman Green called upon Mark Blackburn with Lattimore, Black, Morgan & Cain, CPAs. Blackburn addressed the Board concerning the financial and compliance audit performed for the fiscal year ended June 30, 2013. The audited financial statements and the auditor's required communication letter were provided to each Board member in advance of the Board meeting. Blackburn stated that there were no significant audit findings. He noted that this year's financial statements reflect the words "net position" instead of "fund balance" and the related presentation due to the implementation of Governmental Accounting Standards Board ("GASB") Statement No. 63. He stated that the audit

opinion is the same unqualified audit opinion as issued in prior years, with the same notation as to the manner that unrealized gains and losses on investments is presented.

Blackburn referred to the auditor's required communication letter and noted that sensitive estimates used in preparing the financial statements, such as reinsurance recoverability, the actuarial valuation of loss reserves, and the valuation of investments, had been tested in the audit and concluded to be reasonable as presented. Blackburn noted that there were no difficulties encountered with management, and there were no misstatements noted during the audit. There were no disagreements with accounting or auditing matters, and they are not aware of any independence issues that might impair the relationship between the firm and the Pool.

Blackburn acknowledged that while the audited financial statements had already been provided to and reviewed by Board members, he would be glad to review them to whatever level of detail desired or to answer any questions about them.

Chairman Green asked Board members if there were any questions about the audited financial statements. Peterson asked if Blackburn saw any future GASB changes that might impact how the Pool normally does business. Blackburn responded that an upcoming GASB Statement will affect financial statement presentation and disclosures. Peterson asked if requirements for reporting post-employment retirement benefits and retirement liabilities already kicked-in. Blackburn said no that those requirements become effective beginning next fiscal year and noted that due to the vast change in actuarial methods imposed by the GASB Statement it may be difficult to obtain timely retirement information next year from the Tennessee Consolidated Retirement System. DeMore added that the Tennessee Comptroller's Office has already advised that for this reason FY 2012/2013 pension disclosure information may have to be included in the FY 2013/2014 financial statements if such information is not available for FY 2013/2014.

Motion was made by Senter to approve the audited financial statements as presented; seconded by Wilber. PASSED UNANIMOUSLY

4. FINANCIAL REPORTS

A. Charles DeMore presented the financial statements for the three months ended September 30, 2013. In reviewing the Statements of Revenues, Expenses and Changes in Net Position, DeMore stated that gross earned premium of $16,077,870 was 5.43% or $827,385 more than this time last year. Reinsurance premiums ceded were $2,440,696 which was 3.56% or $83,928 more than last year due to increased workers compensation reinsurance. Net earned premium was $13,637,173 was 5.77% or $743,457 more than last year. Investment income totaled $2,015,748, which is 10.64% or $239,991 less than actual last year. However, compared with budget projections, investment income is $198,248 or 10.91% greater than anticipated for this period. Total revenues of $15,759,006 were $514,792 or 3.38% more than actual revenues for the prior year.

In the expense category, DeMore stated that total losses and loss adjustment expenses of $12,337,141 was fairly flat at 0.77% or $95,878 less than last year. Policy acquisition costs of $2,430,469 were also fairly flat at 0.89% or $21,791 less than last year. DeMore explained that implementation of GASB Statement No. 65 at the beginning of this fiscal year now requires the Pool to expense agent commissions in full at the time the related insurance policies are written, rather than to defer them up front and then expense them monthly over the term of the policies. This required change resulted in an additional $870,625 of agent commissions being expensed as policy acquisition costs for this year and $954,475 for last year, which has also been restated for this GASB Statement. General and

administrative expenses of $1,600,090 were 6.32% or $95,157 more than the prior year actual. However, when compared with the budget, general and administrative expenses were 5.60% or $94,883 less than projected for this period. Total expenses were $16,367,700, which was less than last year's actual expenses by $22,512 or 0.14%. The change in net position before unrealized gains and losses on investments was a decrease of $608,694, which is $537,304 less than this time last year.

This period's change in unrealized gains and losses on investments was $6,701,832 in net unrealized losses compared with unrealized gains of $824,680 this same time last year. The total change in net position for the three months ended September 30, 2013 was a decrease of $7,310,526.

In reviewing the Statements of Net Position as of September 30, 2013, DeMore commented that cash and cash equivalents totaled $14,144,654, and investments totaled $201,981,404. Premiums receivable at the end of the period were $6,230,298. Other assets of $9,307,628 were comprised of accrued interest of approximately $2.5 million and prepaid reinsurance of approximately $6.7 million. Reinsurance recoverable totaled $849,042, and net fixed assets totaled $1,813,711. Total assets were $234,884,832 at September 30, 2013.

Liabilities included net reserve for losses of $125,488,212, which was 1.70% or $2,042,274 more than the prior year amount. The reserve for unearned premiums was $35,227,670; accounts payable and accrued expenses totaled $1,225,203; and, dividends payable totaled $2,340,036 (including $2.3 million of dividends declared for fiscal year 2013/2014). Total liabilities of $164,281,121 represent a 1.90% increase from the prior year. DeMore explained that the beginning net position of $77,914,237 had been restated as presented to reflect the effect of GASB Statement No. 65. When combined with this period's decrease in net position of $7,310,526, net position at September 30, 2013 was $70,603,711.

Peterson asked about the net decease of $17 million in cash and cash equivalents since last year. DeMore explained that cash and cash equivalents includes the Pool's deposits in LGIP which is used to hold funds pending the purchase of suitable investments. For this reason, it is more helpful to view the cash and cash equivalents balance in conjunction with the investment category because of investing activity. When done, the net decrease in these two combined categories since last year is approximately $8.8 million. He called attention to the Other Assets category of $9.3 million and stated that the cash was used to prepay a large amount of the Pool's reinsurance premiums for the current fiscal year.

B. DeMore reviewed the internally-managed fixed income portfolio as of October 31, 2013 as classified by type and maturity. Cash equivalents at that time represented funds invested with the Tennessee Local Government Investment Pool totaling $5,497,954 with an average return of 0.09%.

The Pool's portfolio included 77 fixed income securities consisting of government and agency bonds, more specifically 53 municipal bonds and 24 agency bonds. On October 31, 2013, the portfolio had a book value of $227,798,108 and a market value of $211,142,157, representing an unrealized loss of $16,655,951. The portfolio had an average coupon of 4.036% at October 31, 2013.

Chairman Green asked Board members if there were any questions about the financial reports, and there were none. Motion was made by Rowland to accept the financial reports as presented; seconded by Tharpe. PASSED UNANIMOUSLY

5. DECLARATION OF POLICY DIVIDEND

DeMore presented management's request for the Board to authorize the declaration of a total dividend of $3,000,000 for policies renewing in the upcoming 2014/2015 fiscal year, beginning July 1, 2014. Such

dividends would be distributed as credits to policy premiums and would be allocated as follows: workers compensation - $1,268,500; liability - $1,191,500; property - $540,000.

DeMore noted that this dividend is $1.4 million less than the dividend declared last year and that in the last nine years, the Pool has distributed over $54 million in dividends.

Peterson stated that given the presentation earlier on the capital modeling study, his perception was that the Pool may be a little too dependent on investment income versus having a balance of where we needed to be. DeMore explained that while some other risk pools match the maturity of their investments with claim payouts the Pool does not in order to provide more flexibility in its investment methods and performance. Because the Pool's policy is to hold securities until maturity, the Pool has been able to purchase investments with longer maturity dates and higher interest rates. Over the past few years Crawford has purchased municipal bonds in order to shorten the portfolio's average maturity, which currently is 18-19 years. The presentation addressed the risk of interest volatility that occurs when holding a security with a long maturity while interest rates go higher than the security's coupon rate. In order to be more responsive to interest sensitivity, other types of investment securities are available with shorter maturities, such as 10 years, but they impose other kinds of risks. Also, by going with shorter-term securities, the Pool would be accepting lower interest rates and foregoing investment income.

Crawford added that the Pool's philosophy has been from day one not to do asset matching and in its history, it has not had to sell a security in order to pay a claim or to make payroll. That has given the Pool the opportunity to get more income but you get the risks with that and the presentation addressed the market change risk because we are holding the securities for longer a term.

Peterson commented that it looks like the Pool is now at the 1-in-100 risk level and that at the 1-in-500 level we would be holding too much cash. He asked that based on the presentation it looks like the 1-in-200 or 1-in-300 range is probably the sweet spot that we're looking at. DeMore commented yes, based on the presentation and from conversations with Wick about the study's initial results.

Peterson then asked what does it take to get from our current position to our desired position. Crawford replied that as we have discussed before, the Pool is going to have to ask for additional rate for this next year, but the amount has not yet determined because we have not yet decided how quickly we want to achieve the target. The Pool has distributed dividends for the last 19-20 years and some members have come to expect the dividends each year while others hold the view that if the Pool needs to keep the funds, it should do so. She noted that the conflict we face this year is that we do not want to hit the members with a huge, double-whammy by increasing rates where necessary while taking away dividends as a whole. We want to be sensitive to the members' revenue situations while also realizing business competition. Therefore, we landed on the $3 million dividend declaration recommendation even though it could be used toward capital based on the capital modeling study.

Peterson made two comments. First, he said it is critical that the Board adopt a policy as to what our goal is, whether it is 1-in-200, 1-in-250 risk level, etc. and how we are going to get there and how soon we are going to get there. In that way the Board gives the staff direction as to what the Board wants to do and gives the Board a benchmark to compare how it is progressing. Secondly, since we are looking at a premium increase next year, are the majority of our members better served by this dividend or by taking the $3 million and lowering the premium increase?

Crawford responded that from a perspective of rate versus dividend, dividend is on the balance sheet whereas rate impacts revenues and expenses. If rates are inadequate, we will not be getting enough revenue and will be showing an operating loss for that year and possible years going forward.

Dividends are based on the Pool's results and members' performance based on historical financial activity. One is a look-back benefit, the other is a question of adequate pricing for this day and going forward.

Rowland asked which method puts us in a better competitive position. Chairman Green added probably a little of both. Crawford agreed and said it depends on the insurance market, which right now is a hard market. At this state at where the market is, competitors are still increasing their rates as well.

Senter asked what the average dividend would be. Crawford said that before the current dividend recommendation the average dividend declaration is about $4.9 million.

Chairman Green commented that over the years dividends have come down because of our reduced rates. A few years ago the Board decided to split up the dividends returned and the rate reductions to about half and half.

Crawford added that we have used dividends over the last several years to not increase rates but we are now at a point where we can no longer keep doing that. We have to have a point where what we are pricing is sufficient for what we are spending and that is where we are.

Peterson asked based on the approach that we have used for the last 7-8 years, to do the rate increases that we really need to do what would that do to us competitively in the market? Crawford stated that we do not intend to request the full amount of the property rate increase as noted in the rate study all in one year. We recognize that it will take several years to phase-in the rate increase.

Senter asked about notification of future rate increases, and Crawford replied that rate increases are normally presented at the next Board meeting which would be sometime in March.

Wilber asked whether there was some way to know before then since many members will be well into their budget process by then. Crawford said that if the Board would like to meet before then, it would also help the Pool staff with their internal processes. By convening sometime in February it would help members in their budget process with more relevant information and allow us to get our work done more efficiently.

Chairman Green stated that if it would help staff and members for the Board to meet earlier then the Board can. Peterson asked if it is possible to look at the dividend and next year's rate in the same Board meeting to which Crawford replied yes. He stated that he would like to do that and talk about those two things at the same time in order to balance them out.

Peterson made a motion for the Board to meet in February sometime and to defer action on this recommendation of a dividend declaration until that February meeting to consider both rates and dividend then; seconded by Wilber. PASSED UNANIMOUSLY

Peterson asked if it would be possible and if it would help staff and with competition if the Board were to consider rates and dividend at the November/December Board meeting next year and in subsequent years. Crawford said she believes we would need more time to prepare premium projections since we are now beginning discussions with reinsurers and are attempting to obtain a reasonable indication from them in January as to reinsurance rate increases instead of waiting until April or May as they did this past year.

6. DATE OF NEXT MEETING

The date of the next meeting was initially suggested as Tuesday, March 18, 2014 at the Pool's office in Brentwood, Tennessee. However, after discussion among Board members it was their consensus for the President to look for an earlier date in February 2014 and to notify Board members, accordingly.

7. OTHER BUSINESS

There was no other business presented to the Board.

MEETING ADJOURNED AT 9:54 a.m. from its regular meeting, after which the Board convened in Executive Session.

Tommy Green, Chairman

Charles DeMore, Secretary