



City Council Memorandum

City of Arts & Innovation

TO: HONORABLE MAYOR AND CITY COUNCIL DATE: FEBRUARY 25, 2025
FROM: FINANCE DEPARTMENT WARDS: ALL
SUBJECT: ANNUAL FINANCIAL REVIEW OF THE CITY'S SELF-INSURANCE TRUST FUNDS FOR FISCAL YEAR 2023/24

ISSUE:

Receive the financial overview of the City's Self-Insurance Trust Funds for Fiscal Year 2023/24.

RECOMMENDATION:

That the City Council receive the annual financial review of the City's Self-Insurance Trust Funds for Fiscal Year 2023/24.

FINANCE COMMITTEE RECOMMENDATION:

This report is published on February 13, 2025, for the February 25, 2025, City Council meeting. On February 12, 2025, the Finance Committee will receive and provide input on this item.

BACKGROUND:

Beginning in Fiscal Year (FY) 2015/16, City staff began presenting to the City Council, through the Finance Committee, a financial and operational review of the City's Self-Insurance Trust Funds, including claim activity. This review includes the Workers' Compensation and General Liability Funds.

The Human Resources Department administers the City's Workers' Compensation program. The Risk Management Division of the Finance Department oversees the General Liability program, while the City Attorney's Office administers all third-party claims submitted to the City.

The City purchases commercial insurance to mitigate the costs of high-severity losses, catastrophes, and high-frequency losses that exceed the City's self-insured retention (SIR). An SIR is the dollar amount that the City must pay before an insurance policy responds to a loss. The City's General Liability program includes a Primary General Liability policy and two excess policies. The Primary General Liability policy provides an aggregate limit of \$5 million, while the Excess General Liability policies provide an additional \$20 million of coverage. Both the Primary

and Excess General Liability policies cover general and auto liability claims, including, but not limited to, Law Enforcement Liability and Public Officials' Errors and Omissions. The City also maintains an excess Workers' Compensation policy with an aggregate limit of \$25 million.

The General Liability and Workers' Compensation programs had self-insured retentions (SIR) of \$3 million through FY 2023/24. However, the General Liability SIR increased to \$4 million beginning July 1, 2024. This change will not affect any claims submitted to the City before that date. In practice, this means the City must pay the first \$3 million (\$4 million as of July 1, 2024) of each General Liability claim and the first \$3 million of each Workers' Compensation claim. The City's excess insurance policies will then cover the remaining claim obligations up to the aggregate limits specified in the policy declarations. The City is responsible for paying any additional claims costs incurred exceeding the aggregate limits and self-insured retention. The following examples illustrate how large claims against the City may be paid.

SIR Example 1:

A jury awards a claimant a \$4 million settlement for a general liability claim filed prior to July 1, 2024. The City will pay the first \$3 million of the claim according to its SIR, and the City's excess carrier will pay the remaining \$1 million. After this settlement, \$24 million of excess coverage remains available for claim obligations incurred within the same policy period.

SIR Example 2:

A jury awards two employee workers' compensation claims. Employee #1's claim is \$2.5 million, and Employee #2's claim is \$5 million. The City will pay 100% of Employee #1's claim because it does not exceed the City's \$3 million SIR. For Employee #2's claim, the City will pay the first \$3 million of the claim according to its SIR, and the excess carrier will cover the remaining \$2 million. Following these claims, \$23 million of excess workers' compensation coverage remains available for claim obligations incurred within the same policy period.

General Liability & Workers' Compensation Policy Structure	
General Liability	Workers' Compensation (WC)
Allied World National Assurance Excess Layer #2 \$10,000,000 per Occurrence \$10,000,000 Aggregate	Safety National Excess WC \$25,000,000 Aggregate
Homesite/Kinsale Excess Layer #1 \$10,000,000 per Occurrence \$10,000,000 Aggregate	
Safety National Lead Layer \$5,000,000 per Occurrence \$5,000,000 Aggregate	
Self-Insured Retention \$3,000,000	Self-Insured Retention \$3,000,000

Two claims settled in the last 10 years exceeded the City's self-insured retention.

During each insurance renewal cycle, the City's excess carriers evaluate the City's existing SIR structure to ensure it is appropriate and to determine if a more beneficial (less risk exposure) option exists.

All City departments contribute to the Self-Insurance Trust Funds based on their share of liability and actuarial estimates of the amounts needed to fund prior, current, and incurred but not yet reported (IBNR) claims.

DISCUSSION:

Financial Overview

Attachment 1 provides an overview and analysis of all revenues and expenditures for the Self-Insurance Trust Funds. Historically, the two largest cash outlays from those funds are claim payments and legal fees. In FY 2023/24, claim payments totaled \$5,191,000 for the Workers' Compensation Fund and \$5,882,000 for the General Liability Fund, represented a combined increase of 44% as compared to the prior year. The City received four (4) COVID-19 related Workers' Compensation claims in FY 2023/24, all of which have been closed. Three (3) COVID-19 claims from FY 2022/23 remain open and are being represented by legal counsel. In FY 2023/24, the City paid \$9,410.80 related to COVID-19 Workers' Compensation claims.

General Liability claims are categorized as Bodily Injury or Property Damage claims. In FY 2023/24, \$5,630,557 (96%) of General Liability claim payments were for bodily injury claims, while \$251,904 (4%) were for property damage claims. Three (3) bodily injury claims exceeded \$250,000, with the largest settlement being \$4,000,000 for an employment practices claim. Property damage settlements during the fiscal year ranged from \$74 to \$18,537.

Claim payments are influenced by many factors, while legal fees result from claims in process or initiated during the year. For FY 2023/24, legal fees for the Workers' Compensation and General Liability funds were approximately \$128,000 and \$1,463,000, respectively. Factors such as the number, type, and complexity of lawsuits contribute to higher outside legal expenses. The City continues to assess and prioritize the use of in-house legal resources before seeking outside defense and legal staff.

Cash Position and Fund Balance

The total cash currently on hand across both funds is approximately \$29.3 million, reflecting an increase of \$2.9 million from the prior year. This increase is primarily a result of additional departmental contributions of \$2.6 million to achieve the required policy reserve in FY 2023/24.

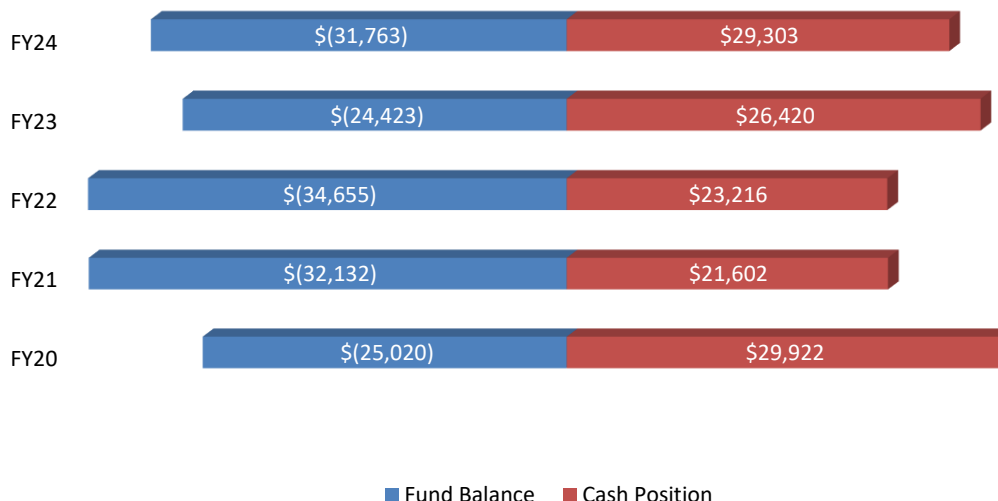
The fund balance remains negative, reflecting the long-term nature of the claims. In other words, the current cash on hand is insufficient to cover all potential claims and liability payouts over future years. However, from a cash flow perspective, the trust fund can meet current obligations, as these liabilities are typically paid out over multiple years. At present, the trust funds hold sufficient cash on hand to cover 48% of its long-term liabilities.

On November 28, 2017, the City Council approved the Self-Insurance Trust Funds Reserve Policy establishing a 40% minimum funding level of the total combined current claims liability outstanding for the Self-Insurance Trust Funds effective June 30, 2018, increasing that minimum level to 50% effective June 30, 2020. Additionally, if at any future point of measurement, the cash balance in

any of these funds is more than 25 percentage points above the required minimum balance (e.g. above 75% after June 30, 2020), then staff must present a plan to the City Council as part of the subsequent budget process to reduce charges to the contributing City funds in a manner proportionate to the way that the funds were originally contributed. As of June 30, 2024, the audited cash on hand is approximately 48%.

Cash Position and Fund Balance

(In Thousands)



Claims Liability

It is important to recognize that the claims liability amount recorded in each fund is an estimate of the amount ultimately required to settle outstanding claims. Claims are often resolved for less than the total amount reflected in the claims liability figure, meaning that the full amount of cash is not required to cover the total claims liability. Additionally, in both funds, but particularly for Workers' Compensation, the actual outlay of cash is many years away (as many as 30 years or more) for much of the outstanding liability.

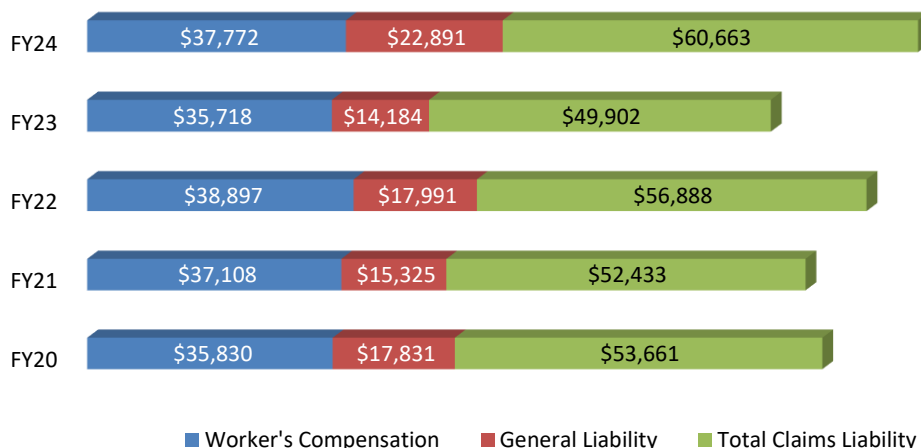
As a self-insured entity, the City must value its claims liability for incurred losses and maintain appropriate reserves to meet these future obligations. In accordance with accounting standards, the City engages an actuarial consultant to perform a complex analysis of claims for both the Workers' Compensation and General Liability funds, the result of which determines the total claims liability for each fund at the close of the fiscal year. The recorded estimate for total claims liability is based on the result of this study and includes an estimate for claims incurred but not yet reported and allocated loss adjustment expenses. The actuary's liability estimate incorporates several factors, including inflation, recent claim settlement trends, claim frequency, payout amounts, and broader economic and social considerations. The claims liability is adjusted annually based on the actuarial study, with the adjustment recorded as an actuarial adjustment expense in the financial statements (see Attachment 1).

The total claims liability trend, as determined by the actuary, has been increasing for several years. In FY 2023/24, both Worker's Compensation and General Liability experienced increases in their claims and judgment liabilities due to several factors. A decrease in the reserve discount factor – from 2.89% in the prior year to 2.75% in FY 2023/24 – resulted primarily from lower interest rates and an increase in projected payroll. The increase in the self-insured retention from

\$3 million to \$4 million beginning July 1, 2024, as well as seven large open employment-related claims further contributed to the increase in General Liability.

The following is a historical overview of the claims and judgment liability trends for the General Liability and Workers' Compensation funds.

Claims and Judgment Liability By Fund (In Thousands)



Due to the predictive nature and multiple assumptions used in internal estimates of claims liabilities and the actuarial study, accurately budgeting for liability adjustments and claims payouts on an annual basis is difficult. The City adjusts departmental rates based on historical trends with the goal of achieving and maintaining the targeted 50% cash balance as a percentage of the total liability. However, calculated reserve amounts will fluctuate from year to year, often being above or below the target due to annual variations in claims payouts and actuarial adjustments.

Departmental contributions to the Self-Insurance Trust Funds are budgeted to achieve a projected policy reserve balance of 50%, while avoiding the accumulation of excess cash reserves, which could divert critical resources away from essential City services. In FY 2022/23, the cash reserve balance exceeded 50%, and the FY 2023/24 cash reserve, based on budgeted departmental contributions, was projected to reach 59%. This projection, based on historical trends, prompted a slight reduction in departmental contributions in the biennial budget encompassing fiscal years 2024/25 and 2025/26. However, the 22% (\$10.8 million) increase in claims and judgement liability, as shown in the previous chart, has resulted in a cash reserve of 48% for FY 2023/24 and a projected cash reserve of 44% for FY 2024/25. Consequently, departmental contributions will need to be increased to regain the 50% policy reserve requirement.

STRATEGIC PLAN ALIGNMENT:

This item contributes to **Strategic Priority No. 5 High Performing Government Goal 5.3** – Enhance communication and collaboration with community members to improve transparency, build public trust, and encourage shared decision making.

This item aligns with each of the five Cross-Cutting Threads as follows:

1. **Community Trust** – The Annual Financial Overview of the City's Self-Insurance Trust

Funds promotes transparency by sharing important information about the funds' financial position.

2. **Equity** – The Annual Financial Overview of the City's Self-Insurance Trust Funds report is available to all members of the public and provides information that can help guide financial decision-making regarding the equitable distribution and fiscal sustainability of internal City services.
3. **Fiscal Responsibility** – The Annual Financial Overview of the City's Self-Insurance Trust Funds report demonstrates fiscal responsibility through the monitoring of the Self-Insurance Funds' financial position, and timely corrective fiscal adjustments, when needed.
4. **Innovation** – The Annual Financial Overview of the City's Self-Insurance Trust Funds report utilizes the most currently available data to help guide decision-making for the delivery of financially sustainable internal City services.
5. **Sustainability & Resiliency** – The Annual Financial Overview of the City's Self-Insurance Trust Funds assists in maintaining short-term and long-term financial health by ensuring the Self-Insurance Trust Funds have sufficient reserves to mitigate risk and provide resiliency and contingencies.

FISCAL IMPACT:

There is no direct fiscal impact associated with this report. However, the Self-Insurance Trust Funds Reserve Policy stipulates that if the combined cash reserve falls below the required minimum balance, staff must present a plan to the City Council as part of the subsequent budget process to restore the balance within three fiscal years. Budgeted departmental contributions for FY 2025/26 to the Workers' Compensation and General Liability funds will be reevaluated during the refresh of the FY 2025/26 budget, which will be presented for re-adoption by the City Council in June 2025, with the goal of regaining a 50% cash reserve in alignment with the policy requirement.

Prepared by:	Ryan Carter, Controller
Approved by:	Kristie Thomas, Finance Director/Assistant Chief Financial Officer
Certified as to availability of funds:	Kristie Thomas, Finance Director/Assistant Chief Financial Officer
Approved by:	Edward Enriquez, Assistant City Manager/Chief Financial Officer/City Treasurer
Approved as to form:	Jack Liu, Interim City Attorney

Concurs with:

Steve Hemenway, Chair
Finance Committee

Attachment:

1. Self-Insurance Trust Fund Analysis
2. Presentation