



City of Arts & Innovation

Financial Performance and Budget Committee

**TO: FINANCIAL PERFORMANCE AND
BUDGET COMMITTEE MEMBERS**

DATE: OCTOBER 14, 2022

FROM: FINANCE DEPARTMENT

WARDS: ALL

**SUBJECT: ANNUAL FINANCIAL REVIEW OF THE CITY'S SELF-INSURANCE TRUST
FUNDS FOR FISCAL YEAR 2021/22 - DIRECT SUBMITTAL**

ISSUE:

Receive, provide input, and forward to the City Council for approval, the annual financial review of the City's Self-Insurance Trust Funds for FY 2021/22.

RECOMMENDATION:

That the Financial Performance and Budget Committee receive, provide input, and forward to the City Council for approval, the annual financial review of the City's Self-Insurance Trust Funds for FY 2021/22.

BACKGROUND:

Effective FY 2015/16, City staff began presenting to the City Council, through the Finance Committee and Financial Performance and Budget 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 has the responsibility for the oversight of the General Liability program, and the City Attorney's Office is responsible for administering all third-party claims submitted to the City.

The City purchases commercial insurance to help mitigate the costs of high severity losses, catastrophes, and high-frequency losses if they expend all available funds. The City's General Liability program consists of a Primary General Liability policy followed by three excess policies. The primary General Liability policy provides the City with an aggregate limit of \$4,000,000, and the Excess General Liability policies provide the City with an additional \$21,000,000 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 purchases an excess Workers' Compensation policy with an aggregate limit of \$25,000,000.

Both the General Liability and Workers' Compensation programs have self-insured retentions (SIR) of \$3,000,000. An SIR is the dollar amount that the City must pay before an insurance policy responds to a loss. This means the City must pay the first \$3,000,000 of the General Liability claims, and the first \$3,000,000 in Workers' Compensation incurred. The City's insurance policies will then respond up until the aggregate limit afforded in the policy declarations. The City is responsible for paying any additional claims costs incurred if the City exhausts each of the policy's aggregate limits in addition to the self-insured retentions. The illustration below shows the thresholds of how large claims against the City may be paid.

General Liability & Workers' Compensation Policy Structure	
General Liability	Workers' Compensation
Allied World National Assurance Company Excess Layer #3 \$10,000,000 Aggregate	Safety National Excess WC \$25,000,000 Aggregate
Allied World National Assurance Excess Layer #2 \$5,000,000 Occurrence \$5,000,000 Aggregate	
Safety National Excess Layer #1 \$3,000,000 Occurrence \$6,000,000 Aggregate	
Safety National Lead Layer \$2,000,000 Occurrence \$4,000,000 Aggregate	
Self-Insured Retention \$3,000,000	Self-Insured Retention \$3,000,000

There have been two claims settled in the last 10 years that exceeded the self-insured retention.

Each year, as the insurance policy is renewed, the existing structure with the \$3.0 million self-insured retention is re-evaluated to determine if a more beneficial (less risk exposure) option exists. This specific structure has been the best option for many years.

All City departments participate in the Risk Management program and make payments to the Self-Insurance Trust Funds based on actuarial estimates of the amounts needed to fund prior and current year claims and incidents that have occurred but have not been reported.

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 in the Funds are claim payments and legal fees. Claim payments in FY 2021/22 for the Workers' Compensation Fund and the General Liability Fund were \$4,825,000 and \$2,796,000, respectively. COVID-19 continues to heighten the City's Workers' Compensation exposure as frontline workers continued to fulfill their duties to serve and protect the public amid a global health pandemic. The City received a total of 128 COVID-19 related Workers' Compensation claims; 118 of those claims are now closed and 10 remain open with 3 that are represented by legal counsel. Together, the City has paid a total of \$403,416 in COVID-19 related Workers' Compensation claims.

Furthermore, General Liability claims are subdivided into two categories: Bodily Injury and Property Damage claims. Of the total general liability claims paid during FY 2021/22, \$2,547,000 or 91% were bodily injury claims and \$248,000 or 9% were property damage claims. Three bodily injury claims exceeded \$250,000. The largest bodily injury settlement issued in FY 2021/22 was \$1,757,930 for an employment practice claim. The City also issued one payment that exceeded \$100,000 for property damage claims. Property damage settlements ranged from \$73 to over \$170,000. The largest Property Damage claim settlement paid in FY 2021/22 was for \$174,551.

While claim payments are driven by many factors, legal fees are a byproduct of claims in process and initiated during the year. For FY 2021/22, legal fees for the Workers' Compensation and General Liability funds were approximately \$109,000 and \$2,154,000, respectively. Factors such as the number, type, and complexity of a lawsuit can yield to higher outside legal expense costs. The City continues to assess and prioritize all available in-house legal resources before exploring alternative defense and outside legal staff.

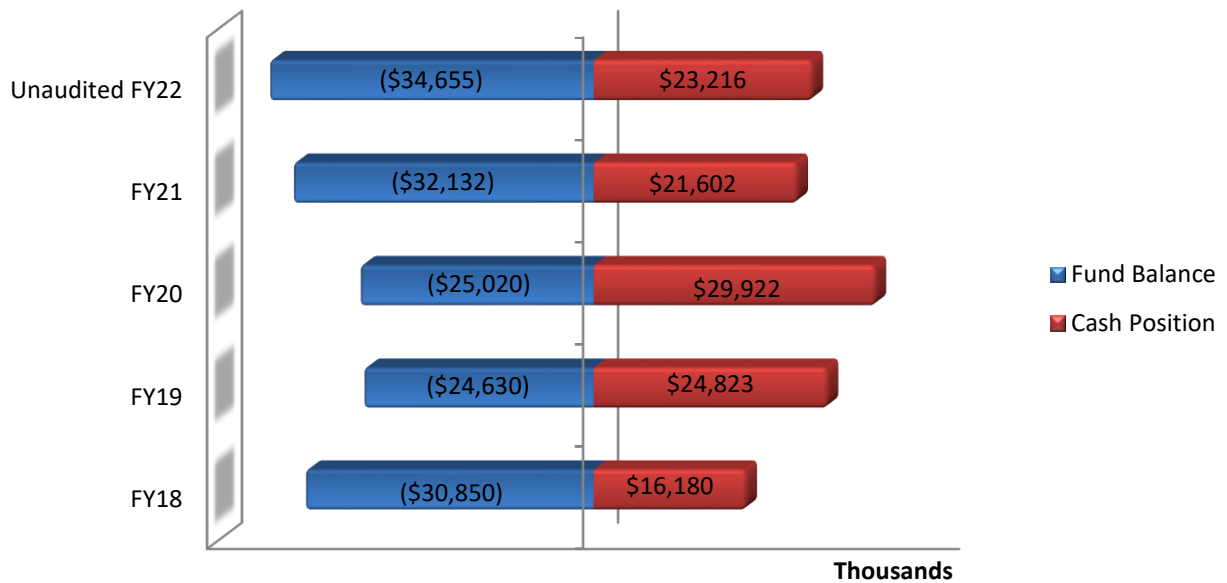
Cash Position and Fund Balance

Total cash currently on hand between both funds is approximately \$23.2 million, an increase of \$1.6 million from the prior year. The increase is primarily a result of the General Fund's additional \$2.5 million contribution from surplus reserves to the General Liability Fund in FY 2021/22.

The fund balance is negative and reflects the long-term nature of the claims. In other words, there is not enough cash on hand now to cover all potential claims and liability payouts expected in future years. However, from a cash flow perspective the trust fund can meet current obligation as these typically occur over multiple years. Currently, there is sufficient cash on hand to cover 41% of the long-term liabilities.

On November 28, 2017, 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. In addition, 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, 2022, the unaudited cash on hand is projected to be approximately 41%.

Cash Position and Fund Balance



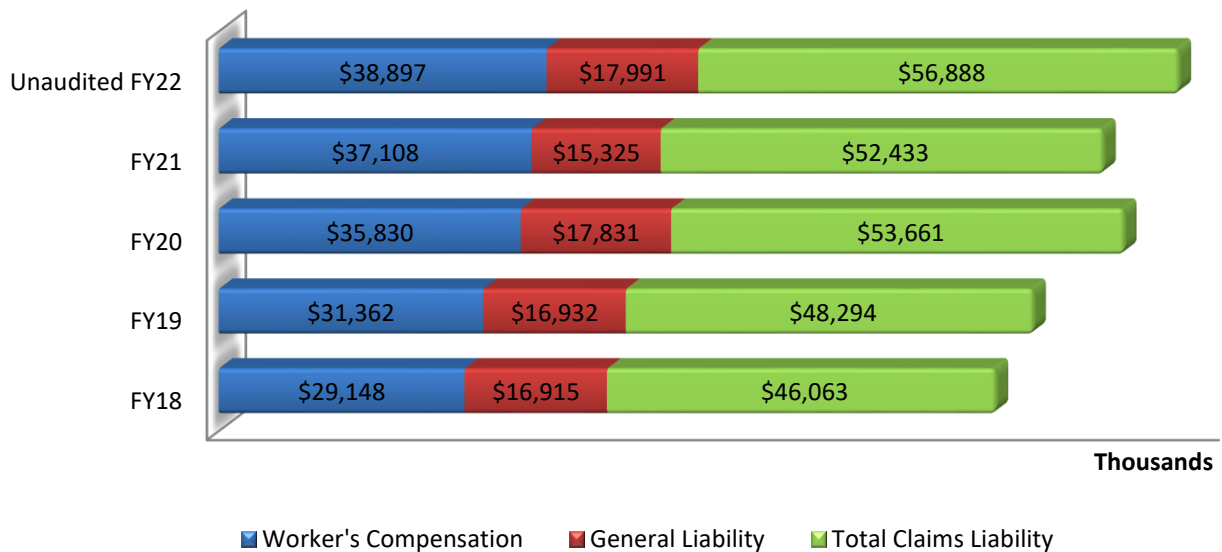
Claims Liability

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

Being self-insured requires valuing the City's claims liability for incurred claims losses and maintaining appropriate reserve funds to meet these future liabilities. 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 is the determination of the total claims liability for each fund at the end of each 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 reported and for allocated loss adjustment expenses. The actuary's estimated liability considers the effect of inflation, recent claim settlement trends, frequency and amount of payouts, and other economic and social factors.

The following is a historical look at the trend of claims and judgment liability for the General Liability and Workers' Compensation funds.

Claims and Judgment Liability By Fund



The trend for the total claims liability, as determined by the actuary, has been increasing for several years. Despite cash outflows being volatile from year to year, the estimated annual increasing liability will create an even greater negative fund balance. Increasing the internal charge for services from departments will have a positive impact on cash position of the trust funds. Still, it will put additional pressure on operating budgets throughout the City. Adjustments to the charges for services for all departments have been incorporated in the two-year budget for FY 2022/24.

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 enhances 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.
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. The Self-Insurance Trust Funds Reserve Policy states that if at any future point of measurement, the combined cash reserve is lower than the required minimum balance, staff must present a plan to the City Council as part of the subsequent budget process (e.g. two year budget adoption or mid-cycle update) to bring the balance above the minimum requirement within three fiscal years. The mid-cycle budget process to update the adopted FY 2023/24 budget will commence in Spring 2023. As part of that update, staff will recommend adjustments to departments’ internal charges as needed to achieve the required policy reserve.

Prepared by:	Nancy Garcia, Controller
Certified as to availability of funds:	Edward Enriquez, Interim Assistant City Manager/Chief Financial Officer/City Treasurer
Approved by:	Edward Enriquez, Interim Assistant City Manager/Chief Financial Officer/City Treasurer
Approved as to form:	Phaedra A. Norton, City Attorney

Attachment:

1. Self-Insurance Trust Fund Analysis
2. Presentation