

City of Arts & Innovation

City Council Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL DATE: OCTOBER 4, 2016

FROM: FINANCE DEPARTMENT WARDS: ALL

**SUBJECT: FINANCIAL OVERVIEW OF THE CITY'S LIABILITY INSURANCE TRUST FUNDS
FOR FISCAL YEAR 2015-2016**

ISSUE:

Approve the financial review of the City's Liability Insurance Trust Funds as of June 30, 2016.

RECOMMENDATION:

That the City Council receive and provide approval of this report reflecting an overview of the financial position of the City's Liability Insurance Trust Funds ("LITF").

FINANCE COMMITTEE RECOMMENDATION:

The Finance Committee met on September 14, 2016, with Chair Soubrou, Vice-Chair Burnard and Member Perry present, to consider a report of the City's Liability Insurance Trust Funds as of June 30, 2016. After discussion, a motion was made by Vice-Chair Burnard and seconded by Member Perry to: 1) receive and order the reports of the City's Liability Trust Funds to be filed; and 2) direct staff to return to the City Council for approval. The motion carried unanimously.

BACKGROUND:

At its April 13, 2016 meeting, the Finance Committee received the first ever update and financial review of the City's LITF. At that meeting, staff committed to returning to the Finance Committee and to City Council, with an annual update on financials through fiscal year-end. This report provides such an update, as of June 30, 2016.

This is an overview of the financial health of the City's LITF, which includes the Workers' Compensation and General Liability Funds. From here on, this report will be presented to the Finance Committee and the City Council annually, providing a financial status on the funds and a review of all claims received, in-process, closed, litigated or otherwise being handled.

The Human Resources Department administers the City's Workers' Compensation program. The Risk Management Division of the Finance Department, through a third party administrator, has responsibility for the General Liability program on behalf of the City.

The City carries insurance coverage to mitigate the most significant losses it may incur. For General Liability losses, the City carries commercial liability insurance in the amount of \$20,000,000 for general and auto liability claims, with a self-insured retention of \$3,500,000 per occurrence. This means the City covers out of funds on hand, the costs of any claim up to the first \$3,500,000 incurred. The self-insured retention increased from \$3,000,000 on July 1, 2016. The City is currently exploring options in the insurance market as this increase is out of character with our claims history. During the presentation of claims history for the LITF the Risk Manager will address factors impacting this increase. After the self-insured retention is met, the insurance policy covers the next \$20,000,000 in claims. If a claim exceeded the combined total of \$23,500,000, then the City would again be responsible for costs out of its own funds.

The situation is similar in structure for the Worker's Compensation program, except that the insurance coverage has a policy limit of \$25,000,000 and the self-insured retention has remained steady at \$3,000,000 per occurrence. The recent increase in self-insured retention only impacted the General Liability fund as the two funds are rated separately. There have been no claims settled in the last ten years that exceed insurance coverage under either program. Each year as the insurance policy is renewed, the existing structure with a \$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 LITF based on actuarial estimates of the amounts needed to fund prior, current and anticipated future claims.

A. Financial Overview

Historically, the two largest cash outlays in the liability trust funds are claim payments and outside legal fees. While claim payments are driven by many factors, outside legal expense is a byproduct of claims in process and initiated during the year. On average, outside legal fees (including litigation costs) for the Worker's Compensation and General Liability funds paid in previous fiscal years approximate \$440,000 and \$2,200,000 per year, respectively.

As of June 30, 2016 unaudited outside legal fees (including litigation costs) are projected to be slightly under budget for the Worker's Compensation Fund and to be approximately \$1,000,000 under budget for the General Liability fund. This is primarily the result of the City Attorney's Office assigning more claims litigation work to in-house staff rather than to outside legal counsel. This is anticipated to decrease total cost for claims handling than experienced in the past. The resulting savings in the Liability Fund were mainly used to balance the FY 2016-18 budget.

Presented below is a historical look at the combined Worker's Compensation and General Liability funds. The main cost drivers in this fund are claims and judgments as well as legal fees (including litigation costs).

| Fund Activity (Thousands) | FY 16 | | | | | 2 Year Budget | | Remaining 3 Yrs of 5 year Plan | | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|--------------------------------|-------------------|-------------------|
| | FY12 | FY13 | FY14 | FY15 | Unaudited | FY17 | FY18 | FY19 | FY20 | FY21 |
| Beginning Fund Balance | \$(12,964) | \$(14,575) | \$(21,856) | \$(26,184) | \$(27,029) | \$(28,691) | \$(29,949) | \$(31,242) | \$(32,422) | \$(33,675) |
| Charges for Services-WC | 4,300 | 4,376 | 4,228 | 6,000 | 6,126 | 6,100 | 6,100 | 6,200 | 6,200 | 6,200 |
| Charges for Services-GL | 7,047 | 7,420 | 7,424 | 7,400 | 7,494 | 7,700 | 7,700 | 7,800 | 7,800 | 7,800 |
| Interest Income-WC | 230 | 183 | 146 | 139 | 179 | 110 | 110 | 115 | 120 | 125 |
| Other Income-GL | 214 | - | - | - | 4 | 3 | 3 | 5 | 5 | 5 |
| Total Revenue | 11,791 | 11,979 | 11,799 | 13,539 | 13,803 | 13,913 | 13,913 | 14,120 | 14,125 | 14,130 |
| Direct Personnel-WC | 473 | 481 | 511 | 551 | 465 | 525 | 555 | 583 | 612 | 642 |
| Direct Personnel-GL | - | - | - | - | 565 | - | - | - | - | - |
| Prof. Serv & Other Non-Personnel-WC | 134 | 96 | 95 | 287 | 109 | 235 | 235 | 247 | 259 | 272 |
| Prof. Serv & Other Non-Personnel-GL | 202 | 178 | 199 | 180 | 199 | 200 | 204 | 214 | 225 | 236 |
| Indirect Charges-WC | 306 | 251 | 261 | 187 | 166 | 166 | 166 | 174 | 183 | 192 |
| Indirect Charges-GL | 457 | 521 | 529 | 315 | 439 | 439 | 439 | 461 | 484 | 508 |
| Claims & Judgments-WC | 3,329 | 3,423 | 4,027 | 3,477 | 4,003 | 3,800 | 3,800 | 3,800 | 3,800 | 3,800 |
| Claims & Judgments-GL | 4,602 | 5,766 | 3,030 | 2,363 | 4,310 | 3,400 | 3,400 | 3,500 | 3,500 | 3,600 |
| Legal Fees-WC | 409 | 428 | 518 | 404 | 435 | 594 | 594 | 564 | 536 | 509 |
| Legal Fees-GL | 1,784 | 3,073 | 2,280 | 1,859 | 1,105 | 2,000 | 2,000 | 2,000 | 2,000 | 2,000 |
| Premiums-WC | 272 | 372 | 390 | 424 | 487 | 436 | 436 | 458 | 481 | 505 |
| Premiums-GL | 374 | 400 | 409 | 439 | 445 | 498 | 498 | 523 | 523 | 550 |
| Actuarial Adjustment-WC | 1,191 | 4,545 | 1,674 | 1,109 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| Actuarial Adjustment-GL | (294) | (514) | 1,932 | 2,554 | 1,500 | 1,500 | 1,500 | 1,500 | 1,500 | 1,500 |
| Misc. Expense-WC | 99 | 167 | 205 | 210 | 205 | 200 | 200 | 200 | 200 | 200 |
| Misc. Expense-GL | 63 | 75 | 67 | 27 | 31 | 178 | 179 | 75 | 75 | 75 |
| Total Expense | 13,402 | 19,260 | 16,127 | 14,384 | 15,464 | 15,171 | 15,206 | 15,299 | 15,378 | 15,590 |
| Ending Fund Balance | \$(14,575) | \$(21,856) | \$(26,184) | \$(27,029) | \$(28,691) | \$(29,949) | \$(31,242) | \$(32,422) | \$(33,675) | \$(35,135) |
| Cash Position | \$13,079 | \$9,977 | \$9,023 | \$11,611 | \$12,419 | \$13,660 | \$14,902 | \$16,323 | \$17,865 | \$19,290 |
| Estimated Claims & Judgments | \$27,204 | \$31,235 | \$34,841 | \$38,505 | \$41,005 | \$43,505 | \$46,005 | \$48,505 | \$51,005 | \$53,505 |
| Cash Balance as a % of Total Liability | 48% | 32% | 26% | 30% | 30% | 31% | 32% | 34% | 35% | 36% |

B. Cash Position and Fund Balance

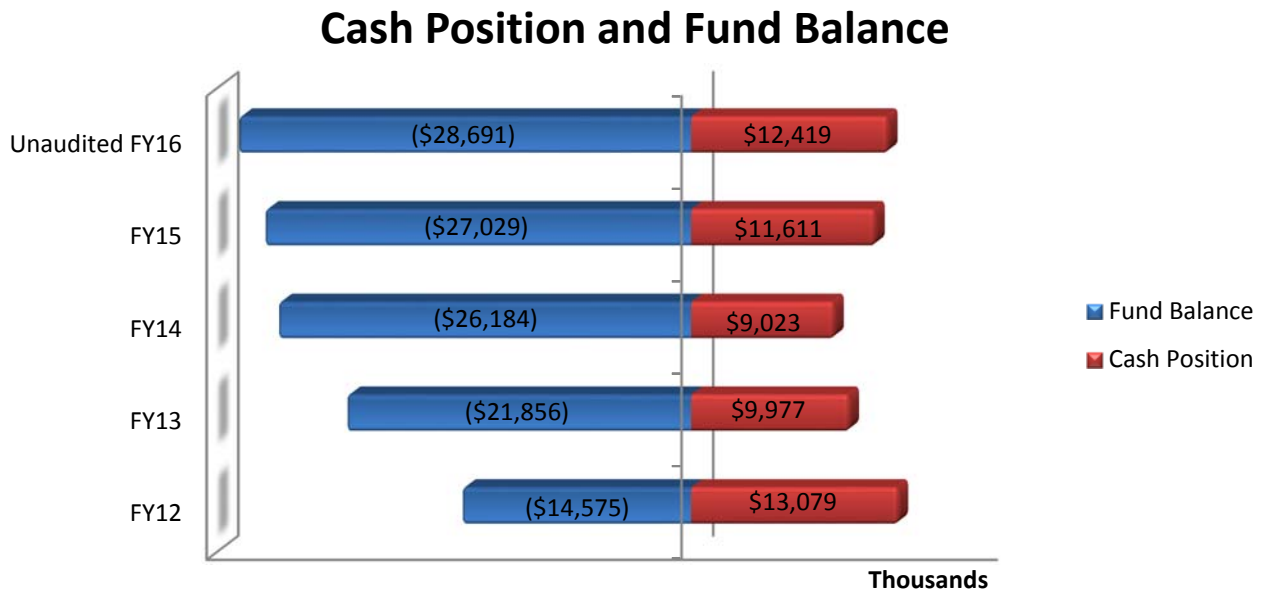
Total **cash** on hand between both funds is currently approximately \$12.4 million. Cash can be used by either fund as needed, but for financial tracking purposes and the rate setting process, it has been accounted for separately.

The **fund balance** is negative and reflects the long term nature of many 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. Generally, currently there is sufficient cash on hand to cover 30% of the long-term liabilities; this amount is projected to increase to 36% by the end of the five-year term.

It is generally not good practice to keep cash on hand to cover 100% of anticipated future liabilities. Staff is developing a policy to recommend to the Finance Committee as to what an appropriate level of funding should be. Staff is looking at cities across the country to determine the “best practices” in this regard. To date, few cities have been found that have any formal policy as to what level of funding is targeted for this type of liability. Alternatively, simply identifying the level of reserves held by various comparable agencies with similar programs may serve as a proxy for the lack of identified formal policies. In all cases, an improved funding position will be recommended; that will increase the internal charges to

the departments for each of these programs. The policy is anticipated to be brought forward to the Finance Committee in the near future.

The fund balance deficit in the General Liability Trust Fund is being addressed through increases in internal charges for services with the intent of bringing the cash position of the fund to a reasonable ratio above 36%. However, this effort presumes that significant costs for claims and legal fees will be controlled. Claims expenditures being higher than anticipated in recent years has had a deteriorating effect on this effort and extends the recovery time until the fund is again in a desirable cash position.



C. 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 Worker's Compensation and General Liability fund, 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.

Following is a historical look at the trend of claims and judgment liability for the General Liability and Worker's Compensation fund.

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 annually increasing liability creates an even greater negative fund balance. Increasing the internal charge for services has a positive impact on cash position of the trust funds, but puts additional pressure on operating budgets throughout the City.

FISCAL IMPACT:

There is no direct fiscal impact associated with this report. However, as discussed above, the liability funds are currently inadequately funded. Increasing the funding will have impact on the General Fund, which is anticipated to be discussed at the time the reserve policy is presented to the Finance Committee in the near future.

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| Prepared by: | Edward Enriquez, Controller |
| Certified as to availability of funds: | Scott G. Miller PhD, Chief Financial Officer/Treasurer |
| Approved by: | Marianna Marysheva-Martinez, Assistant City Manager |
| Approved as to form: | Gary G. Geuss, City Attorney |

Concurs with:

Mike Soubirous, Chair
Finance Committee

Attachment: Presentation