

City Council Memorandum

City of Arts & Innovation

TO: HONORABLE MAYOR AND CITY COUNCIL DATE: NOVEMBER 6, 2018

FROM: FINANCE DEPARTMENT WARDS: ALL

SUBJECT: ANNUAL FINANCIAL OVERVIEW OF THE CITY'S LIABILITY INSURANCE TRUST FUNDS - FISCAL YEAR 2017-2018

ISSUE:

Approve the annual financial overview of the City's Liability Insurance Trust Funds as of June 30, 2018 for Fiscal Year 2017-18.

RECOMMENDATION:

That the City Council approve the annual financial overview of the City's Liability Insurance Trust Funds (LITF) as of June 30, 2018 for Fiscal Year 2017-18.

FINANCE COMMITTEE RECOMMENDATION:

On October 10, 2018, the Finance Committee, with Chair Adams, Vice-Chair Condor and Member Soubirous present, unanimously recommended that the City Council approve the annual review of the financial position of the City's Liability Insurance Trust Funds (LITF).

BACKGROUND:

Effective fiscal year 2015-16, City staff began presenting to the City Council, through the Finance Committee, financial and operational review of the City's liability 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 and effective July 1, 2018, the Risk Management Division of the City Attorney's Office administers the City's General Liability program.

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 \$3,000,000 per occurrence. This means the City covers out of funds on hand, the costs of any claim up to the first \$3,000,000 incurred. After that, the insurance policy covers the next \$20,000,000. If a claim exceeded the combined total of \$23,000,000, then the City would again be responsible for costs out of its own funds.

The situation is identical for the Worker's Compensation program, except that the insurance coverage has a policy limit of \$25,000,000. The self-insured retention for the Workers' Compensation is also \$3,000,000 per occurrence. 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 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 liability trust funds are claim payments and outside legal fees. Claim payments in FY 2017-18 for the Workers' Compensation Fund and the General Liability Fund were \$5,239,000 and \$3,932,000, respectively. While claim payments are driven by many factors, outside legal expenses are a byproduct of claims in process and initiated during the year. For FY 2017-18, outside legal fees for the Worker's Compensation and General Liability funds were approximately \$424,000 and \$2,707,000, respectively.

Cash Position and Fund Balance

Total **cash** currently on hand between both funds is approximately \$16.3 million, an increase of \$2.6 million from the prior year. The reason for the increase is primarily the result of the General Fund and Measure Z each contributing \$2.5 million to the General Liability Fund in FY 2017/18; however, total claim payments collectively increased by approximately \$3.3 million from prior year totals. The General Fund contribution was a one-time payment. A second Measure Z contribution of \$2.5 million will be provided in FY 2018/19.

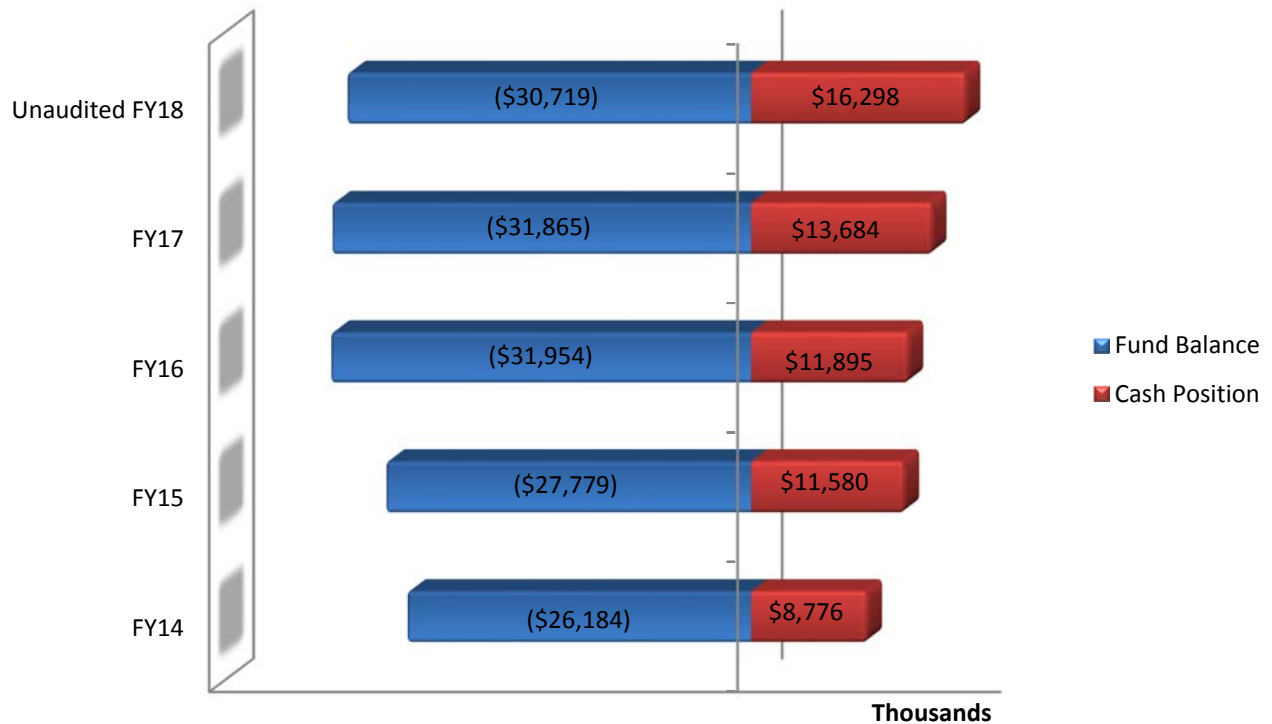
The **fund balance** is negative and reflects the long term nature of many of the claims, in other words, there is not enough cash on hand now to cover all potential claims and liability payouts expected in future years. Currently, there is sufficient cash on hand to cover 35% of the long-term liabilities. This coverage ratio is projected to increase to 48% in FY 2018-19 based on increasing charges for services to the various city departments and a second \$2.5 million Measure Z contribution in FY 2018/19.

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. Staff will continue to monitor activity in the fund and, if necessary, request additional contributions from departments through the mid-cycle adjustment to ensure that the fund meets the targeted minimum funding level of 50% by June 30, 2020.

Even though the cash position in the Liability Funds has improved, claims are rather volatile and unpredictable. The Finance Department will continue to address overall fund balance through

increases in internal charges for services with the intent of bringing the cash position of the Funds to the required minimum funding levels.

Cash Position and Fund Balance



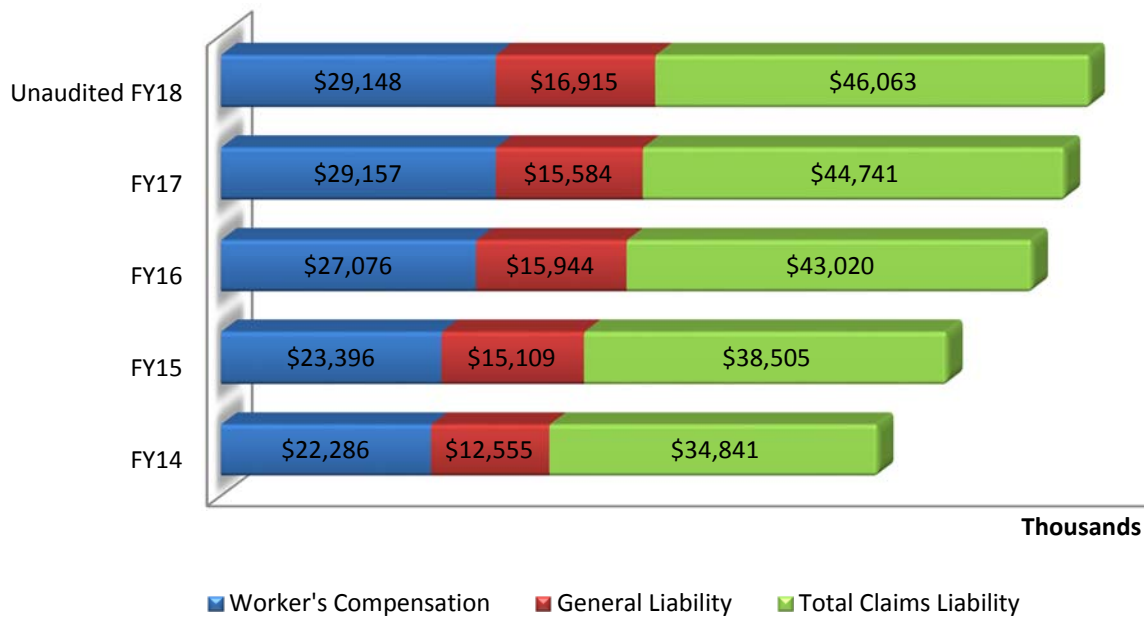
Claims Liability

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 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 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, but will put additional pressure on operating budgets throughout the City.

FISCAL IMPACT:

There is no direct fiscal impact associated with this report; however, the liability funds are currently inadequately funded based on the Self Insurance Trust Funds Reserve Policy, with a projected cash on hand of 35% in FY 2017-18 and 48% by FY 2019-20. Staff will continue to monitor activity in the fund and, if necessary, request additional contributions from departments through the mid-cycle adjustment to ensure that the fund meets the targeted minimum funding level of 50% by June 30, 2020.

Prepared by:	Nancy Garcia, Assistant Controller
Certified as to availability of funds:	Edward Enriquez, Interim Chief Financial Officer/City Treasurer
Approved by:	Lea Deensing, Assistant City Manager
Approved as to form:	Gary Geuss, City Attorney

Concurs with:


 Steven K. Adams, Chair
 Finance Committee

Attachments:

1. Self Insurance Trust Fund Analysis
2. Presentation