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Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

DISCUSSION ITEM

For Meeting of January 20, 2021

RISK SERVICES UPDATE: INSURANCE COVERAGE CHANGES AND THE USE OF THE UNIVERSITY'S CAPTIVE INSURANCE COMPANY, FIAT LUX, AND COMMERCIALLY PURCHASED POLICIES

EXECUTIVE SUMMARY

The University is subject to a wide variety of claims and lawsuits arising out of its diverse operations. The bulk of these claims and litigation are within one of three insured programs – general liability, employment practices liability, and professional liability. The General Liability Program covers injuries caused by slips and falls, automobile accidents, police practices, and student claims of discrimination such as Title IX or denial of due process in the student conduct process. The Employment Practices Liability Program covers claims made by current or former employees for employment torts or statutory violations such as discrimination, harassment, and/or retaliation. The Professional Liability Program covers professional malpractice claims by patients who allege injury during treatment at University medical centers, student health centers, or associated facilities. As of the close of UC's most recent fiscal year (June 30, 2020) there were a total of 1,007 open claims in the three programs with 476 in the Professional Liability program, 193 in the Employment Practices Liability program, and 338 in the General Liability program.

The pending lawsuits are cooperatively managed by the Office of the General Counsel (OGC) and the Office of the President Risk Services (OPRS) in consultation with the local legal affairs offices, local risk management, the affected department, and the University's third-party administrator. This item provides a brief overview of how the programs manage litigation, the role of insurance and reinsurance in funding the litigation and losses, the use of the University's captive insurance company (Fiat Lux), recent changes to the University's insurance coverage, and the evolution of analyzing the University's risk tolerance to optimize the value of its insurance spend.

BACKGROUND

The University's three main categories of insurance are:

- General Liability (GL Program), covering injuries caused by slips and falls, automobile accidents, police practices, and student claims of discrimination such as Title IX or denial of due process in the student conduct process;

- Employment Practices Liability (EPL Program), covering claims made by current or former employees for employment torts or statutory violations such as discrimination, harassment, and/or retaliation; and

- Professional Liability (PL Program), covering professional malpractice claims by patients who allege injury during treatment at University medical centers, student health centers, or associated facilities.

Each of the three programs is largely self-insured as the University retains a significant portion of the risk. The University funds the programs through collection of premiums from the campuses and medical centers, which are transferred to OPRS and then ceded to the University's captive insurance company – Fiat Lux Risk and Insurance Company (Fiat Lux). Fiat Lux uses these funds to provide coverage and payment for losses within the self-insured retention and purchases reinsurance.

Lawsuits are managed by OGC and OPRS, who work together with various constituents at the locations, including campus counsel, campus risk managers, the affected departments, and the University's Third Party Administrator (TPA), all of whom make up the internal defense team.

Individual cases are managed by the internal defense team and outside counsel pursuant to a robust litigation process that investigates and reviews the claims, evaluates liability, sets overall strategy, and makes settlement and trial decisions. Proposed settlements follow the existing Regents' settlement authority process. If parties are unable to reach an acceptable settlement, the matter proceeds to trial, with the Regents receiving updates on the outcome of each trial.

Self-Insurance Program

Once a claim or lawsuit is accepted into one of the programs, the respective program becomes the funding source for the covered litigation, i.e. it pays for defense counsel, any settlement or verdict, administrative costs, litigation costs, and plaintiffs' attorney's fees if the law permits recovery of those fees against the University. This arrangement benefits the campuses and medical centers because they do not have to identify a funding source for each matter as it arises.

Each of the three programs is largely self-insured. This means that the University does not transfer all of its risk of loss to an insurance company, but rather retains a certain portion of that risk and uses its own funds to pay for the retained portion of its losses. The retentions for these three programs currently range from $10 million to $25 million. The University does buy insurance to cover losses that exceed its self-insured retentions.

The University has largely deployed this insurance strategy dating back to 1986. Self-insurance permits the University to reduce costs by eliminating the insurance companies' profit margin,

particularly in the more expensive primary layer of insurance ("First Insurer"). In 2012, the University moved to a self-insurance program involving its captive insurance company – Fiat Lux. This structure realized additional savings as Fiat Lux buys reinsurance rather than commercial excess insurance, and this is generally less expensive. Additional benefits include access to more reinsurance markets and additional limits when available. Furthermore, when needed to fill voids in reinsurance layers, the University also purchases reinsurance from Fiat Lux. This is vital in ensuring continuity of coverage throughout UC's insurance program and is viewed positively by the commercial reinsurance market as it shows that the University is willing to share in its risk at varying levels of liability. Moreover, Fiat Lux is also able to replace the loss of commercially available insurance, due to coverage contraction and imposed exclusions, and provide coverage that is either temporarily or permanently no longer available to the University.

The University funds the programs through collection of premiums from the campuses and medical centers. Each year, Fiat Lux's actuary analyzes the University's pooled loss history and exposure as well as each location's loss history and exposure in order to determine a total cost for expected losses and expenses to manage the overall program (third-party administrator, actuary, reinsurance premiums, etc.). The actuary then apportions this amount to the locations as a premium. The locations transfer the premiums to OPRS, which in turn cedes these premiums to Fiat Lux. Fiat Lux uses these funds to provide coverage and payment for losses within the self-insured retention and purchases reinsurance. One of the distinct advantages of Fiat Lux is its ability to view the University's risks as a portfolio versus individual siloed risks. This allows Fiat Lux to take advantage of programs that are performing better than expected to assist those that are experiencing unexpected adverse losses and development. This affords Fiat Lux the ability to "smooth" the premiums it receives with the intent to provide the campuses and medical centers with lower and more consistent premium rates.

The University has successfully established and maintained stable, long-term relationships with its commercial excess carriers and its reinsurers, subject of course to market conditions, acceptable loss history, and liability exposure.[1] When reinsurers decide whether to quote a reinsurance offer to the University, it is only after an extensive underwriting process. In conjunction with the University's commercial insurance broker, this process typically includes the University completing a detailed application, providing detailed loss history and exposure data, outlining the University's loss prevention and mitigation programs, and a dialogue with the reinsurers to negotiate terms of coverage and amount of premium. Due to the size and exposure of these programs, the University is primarily limited to purchasing reinsurance in the international market (London and Bermuda) which possesses the insurance capacity and liability tolerance the University requires and is not readily available in the U.S. domestic market.

This annual renewal process is not a traditional procurement exercise. Due to the complex nature of the University and its unique risks, the University is often limited to select reinsurers who are interested and willing to extend coverage to the University. It is not uncommon for reinsurers to

[1] Many of UC's historical commercial excess carriers who also participate in the reinsurance market remained on UC's account when the University transitioned from commercial excess to reinsurance with the establishment of Fiat Lux.

not only decline offering coverage to the University, but also routinely to decline to even evaluate the University as a risk and potential client. This requires the University to continually engage with the available reinsurers to exhibit the University's ability to properly identify, evaluate, prevent, and mitigate its risks while successfully managing a comprehensive insurance program.

Each year, the lead reinsurer hires a law firm with claims and litigation experience to audit the programs. The audit reviews the University's claims handling and litigation processes, litigation outcomes, and pending large-exposure cases. The law firm prepares a report for the lead underwriter which is shared with the University and the other reinsurers. As a result of these annual audits, the University has established a reputation of being actively engaged in the development and implementation of effective program management strategies and of being capable of managing its portfolio and responsibly assessing the strength and value of its claims.

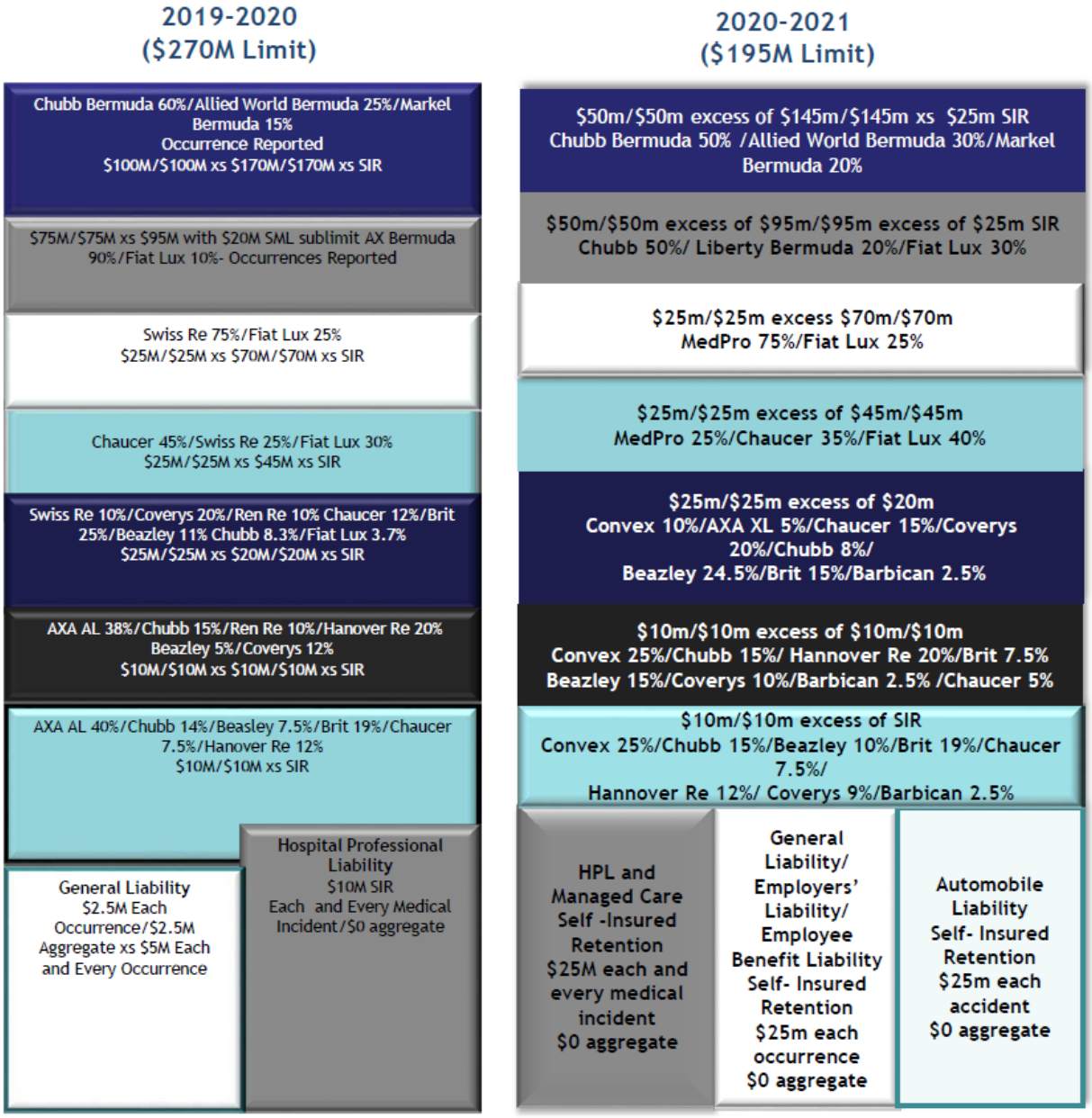
In addition to auditing and reviewing the University's portfolio, reinsurers are notified and participate in case-specific decisions when the anticipated exposure may require a payment by the reinsurer. The representatives are included when the defense team convenes regarding trial and settlement decisions. While their opinions sometimes differ from the consensus of the group, reinsurers, to date, have not refused to pay based on such a difference of opinion.

This degree of participation by the reinsurers is less onerous than what most businesses are subject to in the commercial world. Most insurance policies cede control of the defense to the insurance companies, including whether to try or settle the case, as long as the financial exposure is within policy limits. Given the University's purchasing power, its management practices, and its retentions, reinsurers have not demanded the right to control the defense of the University actions.

Changing Landscape of Insurance

2020 has seen an insurance market unlike any other since the 1980's, characterized by dramatically increased pricing, substantial capacity and coverage contraction, underwriters exiting lines or classes of business entirely, and imposing exclusions for specific types of liability within broader risks.

The University's annual renewal of these programs is effective July 1. Although the 2020 renewal of the EPL Program is unremarkable, the General Liability and Professional Liability Programs experienced significant changes in retention, limit, and coverage which all have led to increased liability to the University. The charts below are an illustration of the University's insurance structure for the past two fiscal years to cover losses in these programs.



Substantial structure changes between FY2019/2020 and FY2020/2021:

- Self-insured retention increased from $7.5 million/$10 million to $25 million/$25 million each and every loss.
- Total available limit/coverage decreased from $270 million to $195 million.
- Fiat Lux reinsurance liability increased from $14,675 million to $31,250 million.
- Complete exclusion of Sexual Misconduct Liability.

Decision and Support

In 2020, OPRS began to adopt a modernized, analytically empowered framework for making insurance decisions, intended to enable OPRS to navigate this difficult marketplace, optimize spending, and ultimately harness the University's tolerance for risk. This journey has seen its first iteration in optimizing insurances for the July 1, 2020 insurance renewal. Further transformation in harnessing the University's tolerance for risk and ongoing optimization is currently under way.

Optimizing insurance spending calls for understanding the University's risk as a portfolio, not simply as a collection of individual risks. In viewing risks as a portfolio, an organization may recognize natural offsets or hedges between risks, and also assess and exploit inefficiencies in the relative value of insurance transactions. Not all insurances are created equal. Through taking an analytical, portfolio view of the University's insurable risks UC harnesses the power of portfolio and enables the University to arbitrage insurance options to deliver maximum result for dollar, thus optimizing insurance spending. Even in an optimized insurance environment, however, there is more to do in order to effect a full transformation of the University's risk financing strategy.

The next step is to quantify the University's tolerance and appetite for risk. Once defined, one can redefine the question of 'what are we trying to accomplish?' through insurance and self-insurance decision-making. With a clear understanding of the University's financial tolerance for unexpected risk and the level of conservativism OPRS is meant to deploy, OPRS will evolve from being a 'buyer of insurance' to being a 'seller of risk'. It is OPRS' intention to harness a portfolio approach to the University's risk, guided by its tolerance for risk and an agreed approach to conservatism, to design bespoke risk capacity and to deliver maximum de-risking value for dollar. In doing so, UC will have built a framework for a dynamic risk financing strategy which is tuned to the financial imperatives of the University, while pursuing risk financing solutions designed to relate to the University's extremely diverse and unique needs.

Key to Acronyms

GL	General Liability Program
EPL	Employment Practices Liability Program
PL	Professional Liability Program
OPRS	Office of the President Risk Services
OGC	Office of General Counsel
TPA	Third Party Administrator