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Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

DISCUSSION ITEM

For Meeting of March 15, 2023

FIAT LUX, THE UNIVERSITY'S CAPTIVE INSURANCE COMPANY: A TEN-YEAR UPDATE

EXECUTIVE SUMMARY

The purpose of this item is to provide an update on the University's five captive insurance companies: Fiat Lux Risk and Insurance Company (Fiat Lux), UC Health Risk Retention Group (RRG), Eureka Protected Cell Company (PCC), Eureka One, Incorporated Cell (IC), and Sequoia, IC.

The University of California's intent behind forming its captive insurance companies was to utilize them for retained risk finance, access to market rate and capacity, third party business aligned to enterprise risk management, and third party business in the pursuit of new revenue streams. Ten years after the formation of UC's first captive insurance company, the University continues to explore opportunities to achieve financial efficiencies through the expanded utilization of the captive insurance platform.

BACKGROUND

A captive insurance company is a wholly owned insurance company that is licensed and regulated by an authorized domicile to insure the risks of affiliated entities. A captive is also a closely held insurance company whose insurance business is supplied and controlled by its owner, in this case, the University, which is its principal beneficiary. While a captive insurance company is a separate legal entity subject to corporate formalities, its owner oversees and controls the captive's major operations, including underwriting, claims management, policy form, and investments.

In May 2012, the Regents of the University of California approved the University's participation in a captive insurance company domiciled in Washington, D.C. and authorized the President to create other captive insurance companies as needed, with certain provisions. The reasons for establishing a captive insurance company include:

- Accessing better coverage, cost, and capacity for property terrorism risks;

- Smoothing the cost of retained risks by line of business for workers' compensation, general liability, auto liability, professional liability, and employment practices liability risks;
- Taking insurance program successes and deploying them towards building and supporting nascent value-added enterprise risk management oriented third-party solutions; and
- Having a better tool for managing uninsured programs overall such as for the terrorism casualty program.

In September 2012, the University formed Fiat Lux under the District of Columbia's[1] captive insurance law, and on September 28, 2012, the District's Department of Insurance, Securities and Banking issued Fiat Lux's Certificate of Authority. Fiat Lux directly insures almost all of the University's risks, retains a portion, and reinsures the remainder of the risks.

Included in the May 2012 action item (F6, *Formation of a Captive Insurance Company*) was a delegation of authority to the President, in consultation with the General Counsel, to create additional captive insurance companies if (1) supported by the Fiat Lux Board of Directors, (2) they are established and operated for University-related purposes, and (3) each such company's Bylaws require the majority of its board of directors to be University representatives. The President, in consultation with the General Counsel and supported by Fiat Lux's Board of Directors, formed UC Health Risk Retention Group in 2015, Eureka PCC and Eureka One IC in 2018, and Sequoia, IC in 2019.

Risk Retention Groups are specialized forms of captive insurance companies, the parameters of which are established by federal legislation and are overseen in large measure by the National Association of Insurance Commissioners (NAIC). UC Health RRG is a collaboration between UC and a host of non-employed physicians.

Eureka PCC is a protected cell company that does not insure any risks, but rather sponsors individual incorporated cells that reinsure University-related risks (similar to a series of limited liability companies). Eureka One, IC and Sequoia, IC are the two cells sponsored by Eureka PCC and these cells primarily reinsure employee benefits.

FIAT LUX RISK AND INSURANCE COMPANY

The University originally formed a single parent captive to consolidate risk finance activities, allow for the pooling of UC retained risk assets, and to more efficiently finance the University's organizational risk. Fiat Lux has allowed UC to purchase risk transfer directly with reinsurers, fill gaps in insurance coverage, retain risk, and participate with underwriters where it is profitable while maintaining reasonable retentions. Fiat Lux currently reinsures or participates in quota share arrangements for over 40 lines of coverage. The results to date have Fiat Lux creating savings or new earnings for UC in excess of $25 million annually.

[1] California law does not authorize the formation of captive insurance companies.

Since 2012, the Office of Risk Services has dedicated resources and attention to advancing the captive's risk financing activities. Fiat Lux has successfully financed deductibles and retentions through the captive, accumulating investment earnings on the money until it is paid out. Most lines of insurance are now underwritten by reinsurers rather than excess insurers. Greater access to the entire insurance marketplace yields better terms and better pricing. Essentially UC has moved from the retail market to the wholesale market for purchasing risk transfer. With Fiat Lux now participating with casualty reinsurers, on a quota share basis, in premiums and claims at strategic levels throughout the towers of reinsurance coverage, the University has taken advantage of risk transfer cost and capacity arbitrage as and when they occur in UC's risk transfer program. UC has also benefited by replacing commercially purchased insurance programs where federal or governmental backstop is available to a captive insurance company, enabling reduced net cost and greater risk transfer capacity.

In 2016, Fiat Lux transacted a loss portfolio transfer (LPT), where monies from both trusts were moved to the captive, which enabled the University to smooth out the performance of the historical risks as well as provided additional investment earnings. The LPT also provided greater oversight by the Washington, D.C. Department of Insurance, Securities and Banking, improving overall governance, visibility, transparency and infrastructure around the University's risk retention efforts.

Since the formation of the captive, UC has creatively been able to finance many inherent risks and programs that would have been otherwise purchased from the commercial market. For example, the University purchases insurance warranties for most of the equipment it purchases and uses in day-to-day operations. The captive worked in conjunction with Procurement to leverage that insurance spending via Fiat Lux and developed an equipment warranty program to reinsure all the legacy and ongoing UC maintenance and warranty insurance agreements, potentially generating a huge cost saving for the University. Also aligning to UC's enterprise risk management approach, the University's Office of the Chief Investment Officer (CIO) decided to buy representations and warranty policies on its real estate purchases from Fiat Lux. When this coverage is required by the UC CIO's office, it is now purchased from Fiat Lux rather than the open market. Similarly, instead of purchasing stop-loss reinsurance for both UC Care and student health insurance plans through the commercial market when prices were very high in 2016, the University purchased the stop-loss coverages through Fiat Lux to access more affordable rates provided by reinsurers.

Recently, in 2022, Fiat Lux was able to approve the issuance of a dividend back to the campuses and medical centers for $13 million to implement a cyber loss prevention program and $7 million to utilize for the ongoing Risk and Safety Solutions program costs.

UC HEALTH RRG, A RECIPROCAL RISK RETENTION GROUP

In 2017, UC launched a second captive, UC Health RRG (a reciprocal risk retention group) to meet the needs of UC Health chief strategy officers and UC medical centers. Charged with increasing the number of physician affiliates, the chief strategy officers were competing with other hospital systems without all the tools needed, i.e., insurance solutions to cover unknown

liability of past medical malpractice, moonlighting, and day-to-day medical malpractice. Working with Willis Towers Watson, UC developed a solution to insure affiliated physicians to align the physicians with UC Health risk management.

Unfortunately, as the UC medical centers' operational needs changed there was limited utilization of UC Health RRG. The company currently holds $1.8 million in total assets.

In 2022, UC senior leadership, along with the Fiat Lux board, made the decision to dissolve the RRG, which is in the process of being completed.

EUREKA, PCC

Eureka Insurance Company, PCC (Eureka, PCC) was organized and incorporated under District of Columbia Protected Cell Captive legislation in 2019 as the University's "core" cell captive and is utilized to sponsor additional cell captive insurance companies for the University. A core company can do this much more efficiently than building a standalone captive insurance company.

The original feasibility study for Fiat Lux contemplated the establishment of a cell captive structure that would enable Fiat Lux to launch segregated cell captives for use by UC and other public entities and/or educational institutions. Eureka, PCC is a non-risk bearing entity, and its sole purpose is to sponsor new cell captives for the University on an ad hoc basis. There are no direct lines of coverage provided by Eureka, PCC. Currently Eureka, PCC has sponsored two cell captives: Eureka One, IC and Sequoia, IC.

Eureka, PCC was formed as a protected cell company, which allows flexibility for growth in both the short and long term. In the future, management expects to add new cells to the structure as new management engagements are entered into by the parent.

Various goals and objectives of the UC corporate insurance and risk financing operations have led to the decision to form Eureka. The objectives of captive formation are as follows:

- Provide a vehicle to fund the UC's self-insured retentions and gain potential access to the reinsurance market.
- Create a strategic risk management tool for a growing corporate organization.
- Enhance coverage and improve asset protection.
- Generate positive cash flows and add flexibility in funding expansion and growth of UC's risk management programs and general corporate operations.
- Provide a tool for centralizing and controlling risk management activities.

EUREKA ONE, IC

Eureka One, IC (Eureka One) was established in 2019 as an incorporated cell captive insurance company. Under current captive law in the District of Columbia, assets and liabilities in an

incorporated cell captive cannot merge into other captive insurance companies within the cell structure.

Eureka One, IC was sponsored by Eureka, PCC for the express purpose of reinsuring the University's employer paid and employee paid life insurance portfolio previously fully insured with Prudential Insurance Company.

In 2017, UC conducted a study of the financial performance of its Group Life and Accident employee benefit programs and determined to pursue assumption of the programs' liabilities in a captive insurance portfolio.

UC engaged an independent consultant, Willis Towers Watson, to evaluate the merits of captive financing. The consultant recommended retention of all or most of the life risk in a captive. Executive management of UC reviewed the recommendations and authorized implementation for the 2019 policy underwriting year. This program would be retroactively dated to January 1, 2019.

The company began reinsuring Prudential on January 1, 2019, and within four years of operations has accumulated over $23.9 million of shareholder equity.

Captive reinsurance of the employee and employer paid life insurance program is consistent with the University's strategy to manage risk at the lowest possible cost for the University and its faculty and staff. As the company continues to mature and be profitable, the surplus will be used to provide benefit enhancements and lower life insurance premiums.

SEQUOIA, IC

The University of California has had much success in financing certain risks through its captive insurance company platform and seeks to continue to expand the platform with the formation of a new captive insurance company, Sequoia, IC, an incorporated cell of Eureka, PCC.

The expansion of the University's risk financing appetite to third party business, as well as segregation of certain assets and liabilities emanating from certain risk profiles prompted the creation of Eureka, PCC. This core company allows the University to efficiently sponsor additional captive insurance companies with which to more effectively finance the risks of the University, its faculty, staff, employees, students, and alumni. These captive programs housed in Sequoia, IC provide opportunities for third party programs that align with UC's overall enterprise risk management or assist in the pursuit of generating new revenue streams.

Sequoia, IC was established in 2019 to launch various insurance programs to the general benefit of the UC and its employees, students, faculty, and staff. The initial program was a voluntary benefit offering to employees that provides a platform of benefits including accident, critical illness, and hospitalization indemnity insurance. The company began a 60 percent reinsurance

contract with Aflac on January 1, 2020. Currently, the program issues over 61,800 certificates of coverage to employees and writes approximately $19 million in gross written premium.

The second program was a systemwide third party liability insurance program (CampusConnexions Insurance Portfolio) developed in 2009 to provide 12 different third-party liability insurance products to University constituents. Since inception, the program has earned over $23.5 million in premium, with approximately $2.4 million earned annually. These programs have produced well over $18 million of underwriting profits, leading to UC's desire to self-insure these programs using its captive, Sequoia, IC, effective March 1, 2022.

FUTURE INITIATIVES

Fiat Lux, now a ten-year company, is in a strong position and looking forward to implementing other initiatives that will help to continue financing other third-party risks more efficiently in the cell captive structure. These include:

- Student Renters Coverage: Students purchase renter's insurance to protect their personal property from theft, fire, water damage, and other perils from outside insurance companies. Fiat Lux has been working with a potential carrier to offer a "college student specific" product that may be more responsive to their needs.
- Damage Deposit Program: Insurance arrangement provided by Fiat Lux that would replace the "traditional" security deposit approach for the housing it offers to students, faculty, and potential graduates who utilize housing on a fee/rental basis. It would remove financial barriers associated with housing and implement coverage in a much more affordable way for students.
- Pet Insurance: UC is exploring the reinsurance of the systemwide pet insurance program through Sequoia, IC with systemwide human resources to see if UC can more efficiently finance this employee benefit going forward.
- Legal Insurance: UC is exploring the reinsurance of the systemwide legal insurance program through Sequoia, IC with systemwide human resources to see if UC can more efficiently finance this employee benefit going forward.
- A Personal Lines (homeowner/auto) Insurance Program for faculty/staff/employees: UC is exploring the possibility of reinsuring personal lines insurance programs for its employees systemwide.

CONCLUSION

In summary, Fiat Lux, a wholly owned subsidiary of The Regents of the University of California, is achieving its goals of optimizing the University's management of retained and transferred risks. This strategic initiative is enabling the University to reduce the chance of loss, create greater financial stability, and protect its resources. These risks have included conventional insurance such as deductibles under commercial property and casualty risk placements, areas of

insurable risk where the University has chosen previously not to purchase risk transfer and more esoteric risks where commercial risk transfer markets do not offer relevant solutions.

The University has since then been able to build out a cell captive structure that will enable UC to offer insurance to third parties aligned to enterprise risk management. One cell company, Eureka, IC, issues reinsurance to the insurers who currently provide life and disability insurance to employees under long-established employee benefits programs. Such an arrangement decreases the cost of these coverages to both the employees and the University (which funds the basic disability cost for employees) by capturing underwriting profits and corresponding investment income currently retained by the traditional insurance carriers.

The second cell company, Sequoia, IC, has been used to house programs that reinsure and capture new revenue streams, such as UC's voluntary benefit program and CampusConnexions insurance portfolio. The hope is to continue the growth of these third-party alternative risk financing arrangements in this cell captive to help provide surplus that could eventually be returned to the campuses and end-users in ongoing benefit enhancements and loss mitigation program funding.

The University's Executive Vice President and Chief Financial Officer and the Office of Risk Services can provide an annual update on the captives and their activities.

Key to Acronyms

DISB	Department of Insurance, Securities, and Banking
RRG	Reciprocal risk retention group
UCOP	University of California, Office of the President
PCC	Protected Cell Company
IC	Incorporated Cell
LPT	Loss Portfolio Transfer
CIO	Chief Investment Office

APPENDIX:

Board of Directors

The current board of directors for Fiat Lux is as follows:

Name	**Title**	**Board Relation**
Michael V. Drake	UC President	Ex Officio
Nathan Brostrom	UC Executive Vice President and Chief Financial Officer	Ex Officio
Norman Hamill (delegation of Charles Robinson)	UC General Counsel and Vice President – Legal Affairs	Ex Officio

Rachael Nava	UC Executive Vice President – Chief Operating Officer	Ex Officio
Kevin Confetti (Chair)	UC Chief Risk Officer	Ex Officio
Michael Beck	Vice Chancellor and Chief Financial Officer, UCLA	Internal Director
Jarid Beck	Managing Director, Risk Management Advisors	Outside Director
Ron Cortez	Under Secretary for Administration Smithsonian Institution	Outside Director

ATTACHMENTS:

Attachment 1:	Updated Financial Statements as of 12/31/2022
Attachment 2:	Diagram of captive structure

ATTACHMENT 2
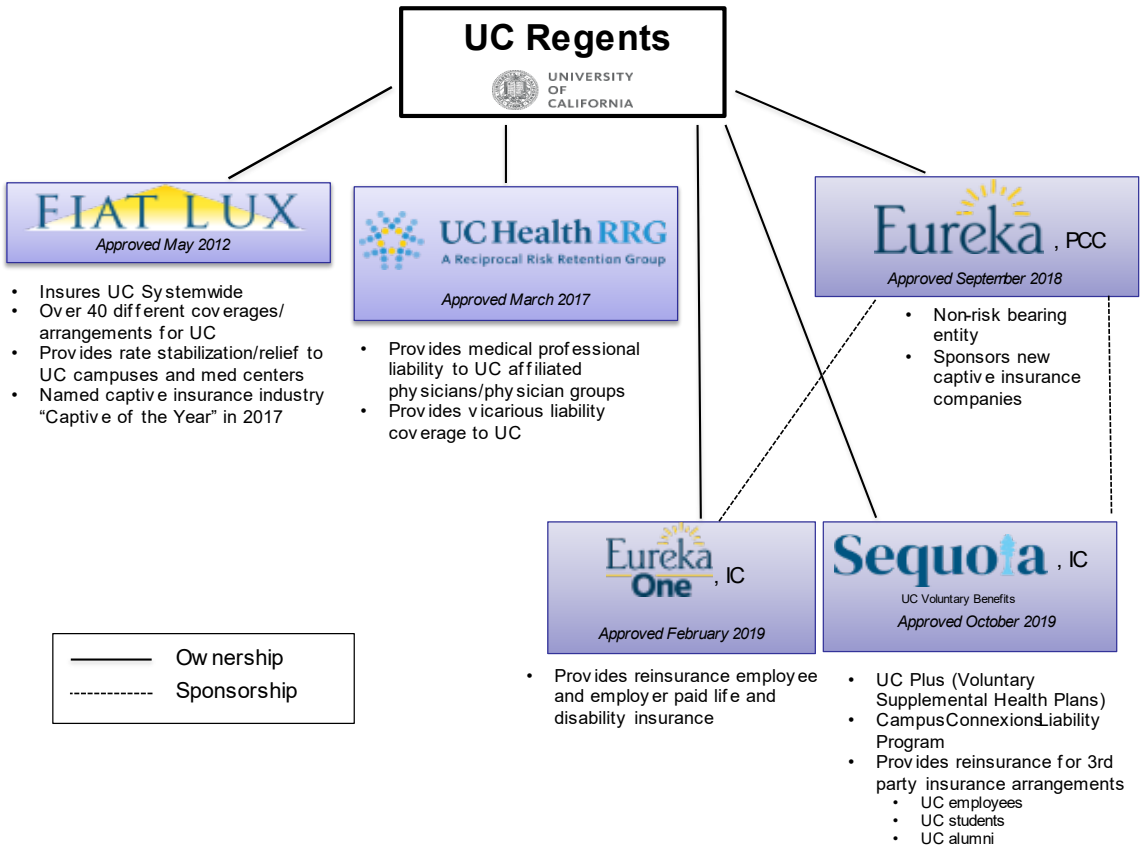
Diagram of current captive structure