



MEMORANDUM

Date: June 15, 2018

To: Councilmember Sally Bagshaw, Chair, Finance and Neighborhoods Committee
Kirstan Arestad, Director of Council Central Staff

From: Ben Noble, City Budget Director
Glen Lee, City Finance Director
Bruce Hori, Director of Risk Management
Greg Narver, Chief Civil Attorney
Joseph Groshong, Director of Torts Section

Subject: Judgment and Claims Fund – Response to SLI 356-1-A

Over fifteen years has passed since the adoption of Judgment and Claims Fund (JCF) Policies through Resolution 30386 in 2001. Substantial JCF expenditures in 2017 prompted CBO and Council Central Staff to jointly develop SLI 35-1-A-2. The SLI required a review of JCF policies. Representatives from CBO, FAS and CAO, comprising a new Judgment and Claims Finance Committee, met weekly over the last few months to review and recommend changes to the policies set forth in Council Resolution 30386, Exhibit A (attached for reference).

The Committee recommends revising three of the 13 policies and adding a 14th:

- A. Policy 4: Budget
- B. Policy 6: Fund Balances
- C. Policy 10: Litigation Expenses
- D. Policy 14: Establish Judgment and Claims Finance Committee

A. Policy 4: Budget

Resolution 30386 provides: *“...each annual budget will be developed based on expected average costs for judgments, claims, and other authorized expenses over the biennium. Subsequent budgets may be developed based on longer-term averages if sufficient information is available to support such projections with the goal of having a predictable and consistent Judgment/Claims budget from year to year.*

CBO generally used a rolling 5-year historical average to set the annual budget of the JCF. The workgroup considered alternative funding approaches and recommends the following funding approach composed of two components:

(NOTE: The discussion below relates only to the General Fund (GF) portion of JCF. At this time there is no recommendation to change the reimbursable (generally utilities) budgeting of JCF.)

1. Annual actuarial reports analyzing confidence intervals¹ of insurable costs.² To better account for large fluctuations in JCF expenditures and to more often avoid supplemental funding

¹ *Confidence interval* is the probability that the actual costs will not exceed the given amount.

² *Insurable costs* are from cases that would be covered by the City’s excess liability insurance, e.g., bodily injury and property damage, should they exceed the City’s self-insured retention.

requests, use of actuarial estimates of expected future payments at a 90% confidence levels is recommended to statistically reduce the chance of exceeding baseline JCF funding to once every ten years. The PricewaterhouseCoopers (PwC) 2017 actuarial model suggests that losses, on average, will continue to increase. This increase will vary annually, as it has in recent years. Thus, an amount that was enough five years ago is very likely to be insufficient now. Note: This budgeting model does not assume use of fund balance.

2. A five-year historical average of non-insurable costs³ adjusted for inflation. The current policies do not address non-insurable costs. They have generally been a small amount; however, they have also increased over the last several years.

The goal is to move from a model that, by design, requires supplemental funding on a fairly regular basis, to a model in which a need for such funding should be statistically infrequent. Although a ramp-up period will be necessary to manage the near-term budget impacts, ultimately funding at the 90% confidence interval is recommended. This provides a high degree of confidence that a supplemental would not be needed and that in 9 out of 10 years (90%) the fund balance will grow. As mentioned above, this model does not assume the use of fund balance in budgeting.

Future JCF GF funding based on actuarial report

2019	50% Confidence Interval	90% Confidence Interval
Actuarial estimate of insurable costs	\$13.6M	\$18.5M
Inflated 5-year average on non-insurable costs	\$ 3.9M	\$ 5.3M
General Fund Contribution	\$17.5M	\$23.8M
2020	50% Confidence Interval	90% Confidence Interval
Actuarial estimate of insurable costs	\$14.9M	\$20.2M
Inflated 5-year average on non-insurable costs	\$ 4.1M	\$ 5.6M
General Fund Contribution	\$19.0M	\$25.8M

Moving from a 50% confidence level (the actuarially projected *average* as opposed to the current rolling average) to a 90% level would be a \$6 million difference for the 2019 budget year. A funding ramp up over five years is recommended beginning with the 50% level in 2019, increasing 10% per year and achieving 90% by 2023.

B. Policy 6: Fund Balance

The statistical probability is that most years the annual contribution to the JCF at the proposed 90% level will exceed costs, creating a fund balance. The fund balance reserve can be used to protect the fund against volatility and avoid the need for mid-year supplemental contributions from the General Fund. The

³ *Non-insurable costs* are for cases not covered by excess liability insurance, e.g., injunctive matters, tax appeals, Sonics litigation, and declaratory judgment matters. Non-insurable costs are calculated from inflated historical costs. They are separated from insurable costs because they are not included in the confidence analysis by actuaries.

variability in non-reimbursable expenditures from the Judgment and Claims Fund ranged from \$5.3M to \$19.5M between 2012 to 2017.

The Committee recommends that fund balance accumulate up to twice the City's then-current self-insured retention (SIR – currently \$6.5 M) for excess liability insurance. The SIR is comparable to a deductible. Fund balance over this amount could be returned to the General Fund. However, if extraordinary judgments/settlements are anticipated the fund balance could exceed this amount on the recommendation of the Judgment Claims Finance Committee.

Using the SIR rather than a fixed number allows the fund balance to track rising self-insurance the City pays on large losses before insurance layers pay. A rising SIR indicates the insurance underwriters believe the City's loss exposure has grown, further reflecting the probability of higher costs.

C. Policy 10: Litigation Expenses

Recommended edits to Policy 10:

The City Attorney and the Director of Finance are authorized to make payment to private and/or public agencies, firms, and/or individuals who provide services to the City in support of any litigation and/or claim and/or threatened litigation or claim filed or ~~contemplated~~ reasonably anticipated against the City, or where the City is a plaintiff or potential plaintiff in legal action. The Judgment and Claims Finance Committee will adopt written guidelines for the implementation of this Policy.

D. Policy 14: Establish Judgment and Claims Finance Committee. [New Policy]

The Committee will consist of members from the City Budget Office, Finance and Administrative Services, and the City Attorney's Office. The committee shall meet four or more times per year. The Committee is charged with oversight measures including: monitoring and reporting on expenditures; reviewing current cases and reserves; advising on the sufficiency of Judgment Claims funding; and considering whether patterns and/or trends in losses may be mitigated with specific risk mitigation strategies. Other participants may be consulted to provide technical, actuarial, or finance advice.

E. Conclusion and Next Steps

If approved, the policy changes recommended by the Judgment and Claims Finance Committee will provide more stability to JCF funding, with a predictable and smooth budgeting strategy. The Committee will meet at least quarterly, or more as needed to closely monitor the fund.

After review and approval of these recommendations by Council, the Committee is prepared to draft a new Resolution to revise the current policies and submit with the Third Quarter Supplemental budget legislation.

Attachment: Current Financial Policies for Judgment and Claims Subfund

CC: Erik Sund, Council Central Staff
Jennifer Devore, CBO
Linda Taylor-Manning, CBO

Addendum

Detail about actuarial confidence interval analysis

2018

The table below assumes an “average” 2018—reflecting the 50% confidence interval. Based on proposed actuarial model the fund would be nearly \$4M short.

2018 Actual Funding		VS	2018 Using Proposed Actuarial Report	
5-year historical average*			2018 Actuarial Estimate insurable costs	\$10.09M
			Inflated 5-year average on non-insurable costs (2012-2016)	\$2.40M
2018 Adopted General Fund Contribution	\$8.84M		2018 General Fund Contribution -- 50% Confidence Interval	\$12.49M

*includes insurable and non-insurable

Because the “average,” or 50% level, will not cover the needs for 50% of years, higher funding levels are needed to reduce the need for supplemental funding. The actuaries have provided an early look at the 2019 and 2020 estimates which will be in an upcoming report.

50% confidence interval for 2019 and 2020:

	2019	2020
Actuarial Estimate insurable costs	\$13.64M	\$14.85M
Inflated 5-year average on non-insurable costs (2013-2017)	\$3.90M	\$4.10M
General Fund Contribution – 50% Confidence Interval	\$17.54M	\$19.05M

Application of the confidence interval to the 2019 average amounts would increase funding as noted below using values from the upcoming actuarial report.

2019 Not-to-Exceed* Confidence Table for Insurable Costs

Confidence level	Not to Exceed Amount	Budget multiplier
50%	\$13.6M	0.00
70%	\$15.0M	0.10
80%	\$16.3M	0.20
90%	\$18.5M	0.36
95%	\$20.8M	0.52

*The confidence level is the probability that the actual costs will not exceed the given amount. For example, the table indicates that there is an 80% probability that the actual costs will be \$16.3M or less.