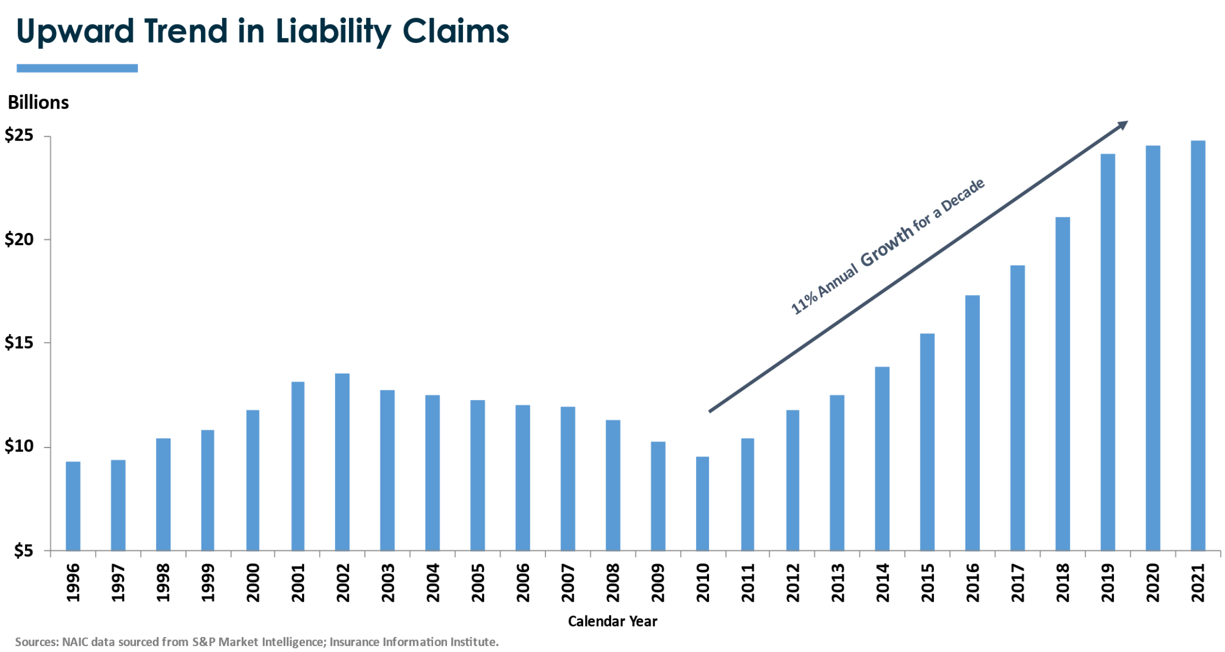
February 16, 2023

To: General Liability Program 1 (GL1) Members

From: Gina Dean, CEO

Re: GL1 Program Stakeholder Communication – Navigating the New Normal

The increase in the number and size of large liability claims continues to create very difficult market conditions. To some extent this is "the same old story" that we have been communicating over the last several years. The difference perhaps, being an increased recognition that the clear uptick in losses (as illustrated in the graphic below) we've experienced across the industry, and across the PRISM GL programs, are not an extended anomaly or a string of bad luck, but rather the new normal. The factors that continue to fuel the increased claims costs are varied and many, but they all result in more and larger claims…frequency of severity. This is a wide-spread issue that particularly impacts public entities, and our members have contributed our fair share of large losses. However, the members are certainly better off together than they would be as individual placements out in the market, and PRISM remains the best solution in navigating this new normal.



Now more than ever it is critical that we maximize our collective strength to address these pressing and increasingly costly issues. It is imperative that we continue to take action to prevent, control and mitigate losses. Lastly, it is important that we all understand the trends and issues that we are faced with so that we can effectively communicate them to our various constituents along with a clear picture of what we are doing together to address them. The attached document is the first step in that effort. It will:

- Further explore the factors driving the losses and the hard market,
- Discuss the risk control resources that PRISM brings to address the loss exposures,
- Describe why being a member of the Program continues to provide value to the members,
- Advise on what you the member can do to mitigate increases,
- Address how the allocation formulas ensure equity among those who have experienced losses and those who haven't yet, and
- Provide talking points intended to help you communicate the message to your management and governing bodies.

To help you fully digest this information we plan to hold several Zoom meetings over the coming weeks where we will discuss the above in greater detail and answer any questions the members may have in reviewing these materials. We are prepared to also have individual calls/meetings with members who may want assistance in preparing communications to their stakeholders. In the meantime, myself and the rest of the PRISM and Alliant staff stand ready to answer questions and assist any way that we are able.

As noted above, the collective financial strength, expertise and resources continue to make PRISM the best solution even, and perhaps especially, through these hard market conditions.

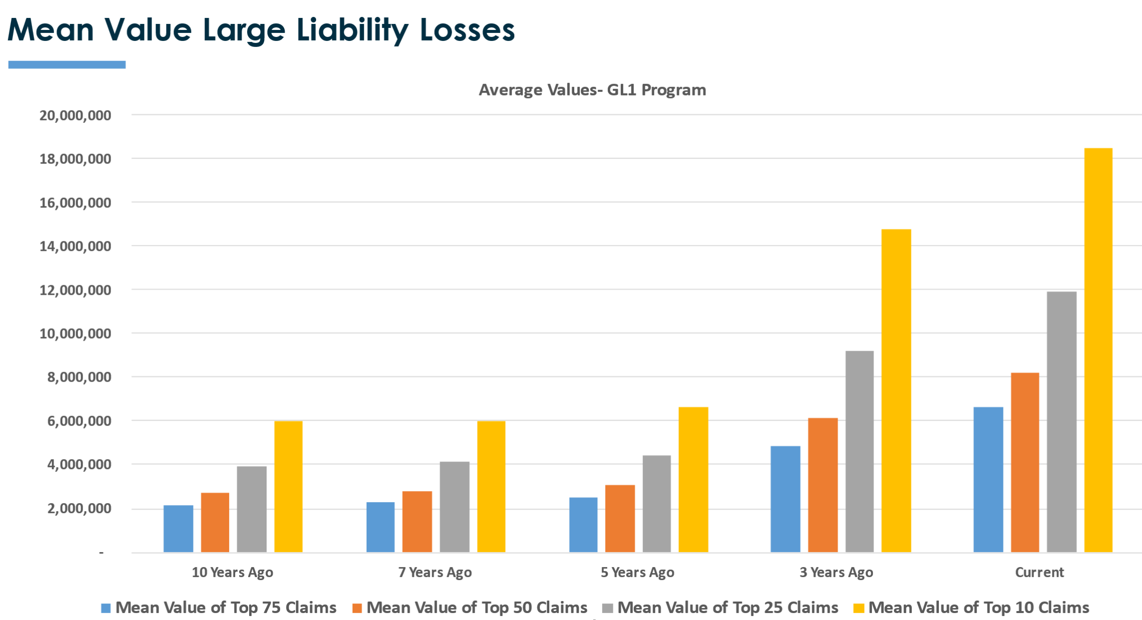
Please don't hesitate to reach out to us for assistance.

Sincerely,

Gina Dean

2023 Liability Insurance Market Update

The hard general liability market that we have experienced in recent years will continue for 2023. The increase in the number and size of extremely large losses over the last 6-8 years are the main contributor. The prolonged soft market that we enjoyed during the 15-20 years prior to the market starting to harden in the late 2010's contributed to the problem. Relatively good loss experience over that time drove competition way up and pricing down to a point that wasn't sustainable, especially once the loss experience changed. And change it did. Starting around 2013-2014, the size of loss outcomes got significantly bigger. Claims that previously had resolved in the $5M-$10M range started costing public entities and their insurers $20M-$30M and higher. This turned out to be an industry-wide trend, but certainly seemed to have its origins in California, and tracks with PRISM's experience as well. The graph below illustrates the change in the average loss amount for the larger losses in the GL1 Program's loss portfolio.

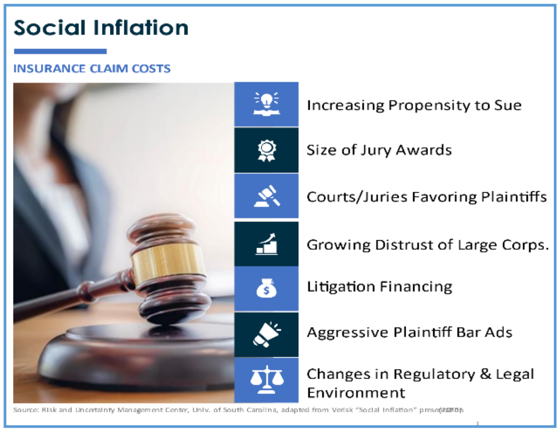


Clearly something changed, and with that change, carriers have been taking steps to protect themselves from what appears to be the new normal. This has included:

- Withdrawing from the market altogether,
- Reducing capacity (amount of limit carriers are willing to put at risk),
- Increasing attachment point,
- Pushing for aggregate limits,
- Restricting coverage through exclusionary language, and
- Dramatically increasing rates.

We expect some or all of the above to continue for the 23/24 renewal.

Why is This Happening

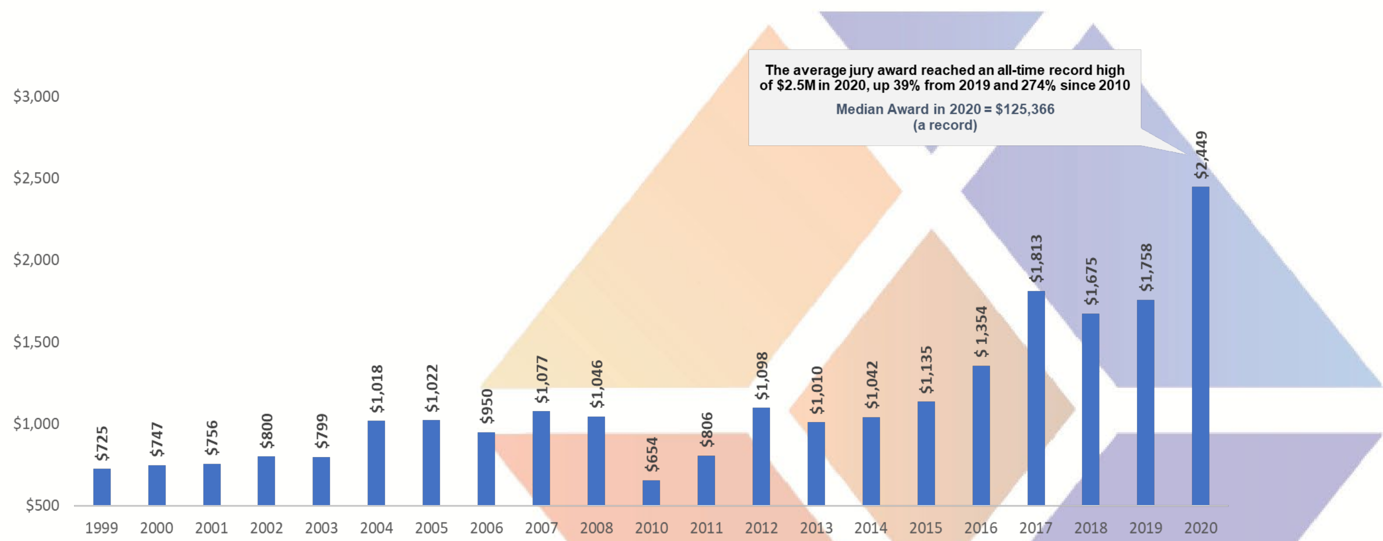


There are numerous reasons for the increased frequency of severity described above, collectively referred to as Social Inflation. Generally defined as “all ways in which insurers’ claims cost rise over and above general economic inflation”, there are numerous specific factors that cause this phenomenon some of which are listed in the box to the left.

Other factors that are often cited are the overall economic disparity between the “haves” and the “have nots”; the changing composition of jury demographics to millennials who tend to hand out bigger awards; the impact of our digital society where public opinion can be formed in 140 characters or less; plaintiff attorney’s use of the Reptile Theory to scare jurors into punishing defendants; and distrust of police who are often “presumed guilty”. Litigation financing deserves specific discussion as it is being used more to fund plaintiff litigation. This practice involves third parties (plaintiff law firms and even private equity) “invest” in a plaintiff’s lawsuit earning a large return in the event the suit is successful, is widely unknown by the general public, and is not required to be disclosed to the jury in most cases. This opportunistic practice is becoming more and more prevalent as the potential returns continue to increase, driving longer more extensive litigation that ultimately leads to larger and more expensive claims.

With all of these factors contributing (and more), it is no surprise that the size of average jury awards has grown steadily over the last two decades as shown below.

Average Jury Awards, 1999 – 2020 (latest available)



Source: Jury Verdict Research; *Current Award Trends in Personal Injury* (61st Edition), Thomson Reuters; Risk and Uncertainty Management Center, Univ. of South Carolina.

These increasing awards include what have been termed “nuclear verdicts” where juries are awarding tens and in some cases hundreds of millions of dollars to the plaintiff(s). Public Entities, especially California Public Entities, are particularly susceptible to what are known as “nuclear verdicts” due to the type of services provided (law enforcement, road design, child services, etc.), and their perceived “deep pockets”. These incredibly large jury verdicts make taking cases to trial very risky, resulting in a propensity to settle at much higher amounts than in the past. Whether it is via jury award or settlement, the numbers just keep going up and up. Some of the largest public entity claims over the last ten years are shown below.

Loss Year	Description	Total Paid
1987-2017	Sexual Abuse (Class Action)	$1,100,000,000
1983-2018	Sexual Abuse (Class Action)	$700,000,000
2017	Sexual Abuse (Class Action)	$464,400,000
2015	Methane Gas Leak	$120,000,000
2015	Bus Shelter Collapse (Single Plaintiff)	$115,000,000
2014	Child Abuse/Foster Care	$113,400,000
2009-2014	Sexual Abuse (Class Action)	$102,500,000
2011	Police Shooting/Wrongful Death	$97,000,000
2021	Wrongful Conviction	$75,000,000
2014	Dangerous Condition/Landslide	$71,500,000
2016	Vehicle Accident/Fire Ambulance	$65,750,000
2016	Wrongful Death	$60,000,000
2015	Strip Search (Class Action)	$53,000,000
2017	Vehicle Accident/Motorcycle vs Auto	$46,000,000
2015	Vehicle Accident/Sherriff Vehicle	$42,000,000
2014	Wrongful Conviction	$40,000,000
2019	Wrongful Death	$33,500,000
2014	Dangerous Condition/Vehicle Accident	$32,500,000
2015	Sexual Abuse	$31,000,000
2016	Dangerous Condition/Vehicle Accident	$30,000,000

Unfortunately, some of the claims above are from PRISM members, and collectively we have had our share of large claims. In fact, over the ten-year period from 2011/12 through 2020/21 the GL1 members have experienced 928 claims that exceeded their self-insured retention (SIR). These claims collectively exceeded the collective SIRs by $695 million for an average of $69.47M per year. When an annual trend factor of 7% is considered, these numbers jump to 1,219 claims with a collective $1.16 billion above SIR for an average of $115.83M per year! This idea of trend is important as insurance carrier underwriters and actuaries apply some trend to the historical claim when trying to project future years’ claims costs based on the historical losses. In recent years we have seen trend factors between 7% and as much as 13% used in these calculations.

It is also helpful to have a basic sense of how insurance carriers tend to look at appropriateness of premium. One measure that is used is loss ratio, or the ratio of dollars of incurred loss to dollars of premium. There is some variation, but liability carriers tend to underwrite to somewhere around a 65% loss ratio. In other words, they want to set their rates so that over the long term incurred losses will make up no more than 65% of the premium charged. This leaves room for expenses, provision for adverse loss experience and profit margin.

We often get questions from members who say, "my entity only has one bad claim that exceeds a certain layer, so why is the premium for that layer so high?" The hypothetical analysis below shows the impact of both trend and underwriting to a 65% loss ratio to that "only one loss in the layer" scenario. In this case the layer in question is the $5M xs of $10M layer, and the entity has only one claim with total incurred in that layer totaling $2M. Based on this raw data, the 10-year average loss is $200,000 and an implied premium based on a 65% loss ratio would be $308,000. Once the 7% trend is applied, there are now four claims with total incurred in the layer, the average jumps to $1.57M and the computed premium to over $2M.

Ground Up Claims	DOL	Total Incurred	Untrended Incurred into *Layer	Years of Trend	Cumulative Trend Factor	Trended Incurred	Trended into *Layer
Claim 1	9/4/2013	$7,750,000	$0	10	1.97	$15,245,423	$5,000,000
Claim 2	2/22/2015	$12,000,000	$2,000,000	8	1.72	$20,618,234	$5,000,000
Claim 3	5/5/2017	$9,500,000	$0	6	1.50	$14,256,938	$4,256,938
Claim 4	4/18/2021	$10,000,000	$0	2	1.14	$11,449,000	$1,449,000
		10-Year Average	$200,000			10-Year Average	$1,570,594
		Premium (priced to LR)	$307,692			Premium (priced to LR)	$2,416,298

*Layer Limit	$5,000,000
*Layer Attachment	$10,000,000
Trend Factor	7.0%
Permissible Loss Ratio	65.0%

The preceding simplified model is applied to one hypothetical member and one layer of coverage. When instead you look at the incurred losses for the Program on the previous page and apply the same concept, it's easier to understand the premium increases that we have experienced.

Better Together

While member loss experience certainly is part of the larger problem, the GL1 Program remains part of the solution. The members are certainly better together. The collective size of the GL1 members allows us to withstand the kind of loss experience depicted above. We are able to leverage our volume to allow for greater self-funding (pooling), and to maintain relationships with our reinsurance carrier partners. We have been creative in our program structure to mitigate the costs increases, and to continue to provide the high excess limits that the membership needs. That being said, the Program will again see rate increases in the coming year, with individual member's changes varying based on their own loss experience. This last part is important to note because the individual member loss experience is a big part of the premium allocation process and those with better loss experience will see less of an impact on their rates, while those loss leaders will see bigger increases. To accomplish this, the allocation includes an experience modification formula for losses in the lower, more predictable layers, and large loss surcharges in the excess layers.

Despite the increases that we've experienced in recent years, it is still much better to be part of the group as compared to individual entities who are facing the same environment on their own. The following are case studies of several "stand-alone" public entities and a couple of pools that we provide as examples of this:

1. **County** with very good loss experience was forced to increase their SIR from $1M to 2M to go along with a 300% premium increase at 21/22 renewal. The county received another sizeable premium increase at their 22/23 renewal.
2. **City** with good loss history. The best terms available in the market at their 2020/21 renewal included a 300% premium increase and doubling of their SIR from $500K to $1M. The City instead joined the PRISM GL1 Program with a 79% premium increase and $1M SIR.
3. **City** with only two losses above the retention in the past 10 years with the most recent loss 7 years ago. Renewal terms from the incumbent for 22/23 were at a 150% increase and included a full law enforcement exclusion.
4. **City** with a clean account over the past 4 years with a $10M SIR. Market pushed a 15% increase for 2022/2023 – despite the fact that over the past 3 years the City had already absorbed increases of 75%.

Other California pools are experiencing difficult renewals as well:

1. **Pool** with good loss history had their SIR increased from $5M to $10M along with a 100% premium increase at the 2021/22 renewal. At the 2022/23 renewal they received an additional 25% premium increase.
2. **Pool** with a 20-year carrier relationship was informed that for 2021/2022 the carrier reduced their capacity from $20M to $10M and pushed the retention from $5M to $7.5M and with a 30% increase in rate. This was followed in 2022/23 with a 10% increase despite no losses over the past two years.

While our renewals in recent years have been challenging, PRISM members have fared much better than most, including the examples above. By staying the course, we will all benefit from our economies of scale, our leverage in the reinsurance markets, and our sharing of best practices to help manage risk and hard markets. PRISM members remain better together.

PRISM's Response

PRISM has always been proactive in managing the GL1 Program with our market allocation approach to help manage the members' costs. Over the last several years, the

Program has been loss challenged, causing some members to take on increased self-insured retentions (SIRs) and/or Individual Member Corridor Deductibles (IMCDs) to manage the increase in premiums. Both are effective tools to explore, and we are happy to work with you to determine if an increased SIR or IMCD is appropriate for you.

PRISM was also among the first Joint Powers Authorities in the nation to setup its own captive insurance company, PRISM ARC. The captive has been used strategically to earn greater investment returns on monies held to pay claims in the group corridor deductible layers. Public entities are very restricted in what they can invest in, impacting overall returns. The captive, while still very conservative, is not as restricted and can therefore generate higher yields. This is a benefit to PRISM members as it allows PRISM to discount the premiums to the members in anticipation of the investment returns.

Two years ago, we entered into a new agreement with one of the largest and most stable carriers in the world, Berkshire Hathaway, to provide reinsurance for the $5M to $10M layer. This proved to be immediately beneficial at their first renewal (7/1/22) when they agreed to an increase at just under 2.5%, which was lower than what loss development would have indicated. Based on preliminary meetings with Berkshire this year, we again expect to receive renewal terms for the 7/1/23 renewal. We also restructured the $9M layer above $10M to include a $5M Program Corridor Deductible and added an additional quota share participant. Both moves allowed us to mitigate price increases and eliminate any member aggregate limits for the Program. For the $6M x $19M layer we successfully renewed with the same quota share partners and with the same terms and conditions as expiring. Finally, we secured optional excess limits to $50 Million to meet the growing need for protection against the ever-increasing claim costs.

While PRISM's premiums will increase for 2023/24, the premiums are still less costly than an entity would likely be faced with outside of PRISM. A testament to the continued competitiveness of the Program are the seven new cities who joined the Program or who joined a member JPA over the last two years at considerable savings compared to their other stand-alone or JPA options. In addition to premium savings, those entities also avoided coverage restrictions and limitations that were quoted outside of PRISM.

Member's Response

There are several steps that can/should be taken during these turbulent times.

1. First, communicate the state of the market to all your stakeholders so there is an understanding that this is an industry-wide problem. We are happy to participate on conference calls or attend meetings to assist with this communication if so desired
2. The severity of claims is on the rise. If you are not yet participating in the Optional Excess Liability (OEL) Program, consider doing so. This Program provides three options of additional limits excess the GL1 Program: $10M, $15M or $25M.
3. Anticipate an increase in your own SIR funding being suggested by your actuary.
4. It may be tempting to consider increasing your SIR to save premium dollars; however, this needs to be weighed against the increased cost to fund the higher

SIR. In addition, given these new severity trends, all things being equal, the bias should be toward transferring risk due to the uncertainty of these changing claim trends.
5. Vigorously defend the claims that are defensible.
6. In a hard market environment, the quality of loss data will undergo additional scrutiny. Make sure your data is in good condition.
7. Stay up to date on maintenance, inspections and trainings.
8. Finally, manage your individual risk by taking advantage of the best practices programs and service partner programs we offer.

To expand on the last point, PRISM Risk Control wants you to know that you are not alone while managing the multitude of risks facing your agency. Our team of specialists is here to help, whether by providing direct consultation or connecting you with one of our trusted partners. Regardless of the topic, we encourage you to reach out to the Risk Control team for assistance with your organization's risk management challenges.

We would also like to call your attention to a few services and resources we think you should be taking advantage of:

General Liability

- PRISM members are provided free access to Labor Law/Employment Practices Services through Eyres Law Group. The service provides members with unlimited telephone calls to ELG, email communications, and/or faxes to answer employment law questions as they arise. ELG also provides step-by step-coaching and advice in a privileged context for employment law decisions and subsequent actions.
- PRISM Partner, A-Check Global, provides an electronic platform that allows employers to monitor employee driving records on demand and provides automatic e-mail notification when a reportable event occurs. The system also includes a record management system.
- Staff has developed a Resource Page specifically for Law Enforcement. The page is designed to be a one-stop-shop for law enforcement related resources including POST approved training, and PRISM service partnerships.
- The School Liability Handbook: Student Activities and Employment Issues was created in conjunction with Lozano Smith, a law firm specializing in school liability legal services. The Handbook consists of 5 modules, such as School Activities and the Law and Employment Issues for School Districts.
- PRISM staff developed a pair of resource documents designed to assist members with Road Maintenance risk. These documents include discussions regarding the use of Geographical Information Systems and other general design and maintenance best practices.

Talking points for the GL1 Program

Individual Claim Examples

To describe the effects of social inflation on claims, below are several summaries of recent jury verdicts and settlements, many of which involve members of PRISM's GL1 and GL2 Programs:

- Jurors awarded $45.4 million against a southern California county to a girl who suffered sexual abuse for two years in a home where she was left despite evidence showing that an accused molester lived in the house.
- Jurors awarded $33 million against a southern California county in a wrongful death case where the deceased attacked several county road workers while under the influence and was killed during the altercation.
- A southern California city was sued for dangerous condition of public property after a 16-year-old was struck by a car crossing a street at a crosswalk near his school. The driver of the vehicle was looking for an item that was on the floor of the passenger seat when he struck the teenager. The teen survived but has multiple injuries including a brain injury. A jury found there to be a dangerous condition and awarded over $23 million against the City.
- A northern California county was sued after a family's vehicle was struck in an intersection late at night by a law enforcement vehicle that was responding to a call without lights and sirens on. Several members of the family were injured, and one young child was left with permanent brain damage. The case was settled for approximately $27 million.
- A southern California city agreed to pay $21 million to resolve a case for wrongful conviction of a man who was incarcerated for 30+ years.
- A southern California city settled a claim for injuries sustained due to a trip and fall on a city trail for $11.2 million.
- A southern California city agreed to pay $12.5 million to resolve a case in which a driver struck and killed a baby and injured the father of the child. The city was sued for dangerous condition of public property as the driver claimed his view was obstructed by foliage.
- A southern California county agreed to pay $12M in a post-trial settlement to the to the family of a man who died after sheriff's deputies restrained him during his arrest. A jury had originally awarded $85M to the family, but a settlement was reached as the County prepared its appeal of the case (there is some hope to be found here!)
- A northern California city paid $12 million to settle a case in which a motorcyclist was struck in an intersection by a police car that was responding to a call. The injured motorcyclist lost a leg in the accident.

Aggregate Claims Trends

- As both frequency and severity have risen for the GL1 Program, just like the general liability industry, the claims trend and lack of capacity will result in anticipated rate increases.
- The natural result of this significant change in losses is that PRISM has adjusted forecasts and rates to account for new loss trends, as have our carriers.

The total number of claims in the GL1 Program over $1M in the last five years has more than doubled. This is a big indication of how jury verdicts (and settlements) are increasing!

Benefits of Being in a Pool

Economies of scale benefits

- Access to insurance options. PRISM's size provides more leverage in the insurance market. It also allows access to the reinsurance markets, which are not available to individual buyers, thus expanding the universe of available coverage options. PRISM has been able to leverage this access and the Program's premium volume to secure unique and beneficial reinsurance agreements.
- Maintaining broad coverage. Public agencies with stand-alone placements are seeing reductions in their coverage limits and/or exclusions. Although GL1 continues to face the potential for coverage restrictions, PRISM has largely been able to maintain broad coverage in the Program.

Equitability

- PRISM's members with large loss experience have better coverage and premium options in the pool than finding coverage alone, but members with less severe loss experience also receive benefits from pooling as they are recognized and rewarded through premium reductions.

General Market and Program Information

- The size of our program, with 129 members, more than $7.8 in payroll and 765,000 ADA, offers great purchasing power to our members and provides much greater stability than smaller programs or individual risks.
- The liability market continues to harden. We continue to see a significant increase in plaintiff demands and high dollar liability claims. Jury verdicts (and settlements) are much higher than they have been in years past and that is affecting the industry's surplus.
- There are many factors causing this including tactics plaintiff's counsel are using (such as the use of the Reptile Theory) to drive up claims' verdicts and settlements. The selection of appropriate defense counsel, who are experienced in dealing with these tactics, has never been more important.

- Markets continue to be more judicious with how and where they deploy their capacity and/or limit their exposure, with some leaving the market entirely. The overall “supply” of limits has been reduced by more than 50% in the last five years. The size, stability, and premium volume of the GL1 Program have attracted markets that may not consider participation otherwise.
- We have always been proactive in our management and funding approach, and this remains the same today. One of the strengths of the GL1 Program is the active involvement of the Underwriting Committee and their ability to be flexible. This approach often means modifying the Program structure and the Program's retained risk to keep premiums as low as possible for the members.
- We are not unique in experiencing rate increases for liability coverage as the claims environment in California and across the nation is increasingly adverse for public entities.
- Our membership has increased in each of the last few years with seven new members joining the GL1 Program since 2021/22. This shows that the Program is still competitive in the market.
- The benefits of pooling shine brightest during a hard market when our economies of scale, our leverage in the reinsurance markets and our sharing of best practices help our members manage risk.