



March 18, 2024

To: General Liability Program 1 (GL1) Members

From: Gina Dean, CEO

Re: GL1 Program Stakeholder Communication – More Frequency of Severity

The continued general liability hard market will again negatively impact us in 2024, and into the foreseeable future. The new normal of increased numbers of very large general liability claims, continues to drive the cost of risk even higher and is having a dramatic impact on the insurance market. The factors that continue to fuel the increased claims costs are many and interrelated, 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, our members are certainly better off together than they would be as individual placements out in the market, and PRISM remains the best solution in withstanding even more frequency of severity.

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 resources that PRISM brings to address the cost of risk,
- 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.

PRISM will hold several virtual 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.



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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,

A handwritten signature in cursive script that reads "Gina Dean". The signature is fluid and elegant, with the first and last names clearly distinguishable.

Gina Dean

2024 Liability Insurance Market Update

The hard general liability market that we have experienced in recent years will continue in 2024, and for the same reasons. The increase in the number and size of extremely large losses over the last decade are the main contributor. Starting around 2013-2014, large liability claims activity increased significantly. Extremely large verdicts and the resulting increased settlement values have had devastating impacts on the economics of liability claims. Claims that previously had resolved in the \$5M-\$10M range started costing public entities and their insurers \$20M-\$30M and higher. This increased frequency of severity 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 trend has continued and even worsened in recent years. An October 2023 Swiss Re Institute report notes that US liability costs have risen by an annual average of 16% over the last five years (2018-2022).

Carriers who, in retrospect, had been pricing the exposure below these new loss costs have been forced to take drastic action to protect their bottom line. These actions have 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.

Some or all of these will continue for the 24/25 renewal.

Nuclear Verdicts

We have likely all heard the term “nuclear verdicts”, but what are they and why are they happening with more frequency? Any exceptionally high jury award that exceeds what would be considered a reasonable or rational amount can be considered a nuclear verdict, but legal experts officially define a “nuclear verdict” as one that exceeds \$10M. This amount would have been something very rarely observed as recently as 10 years ago but is now a disturbingly frequent fact of life. Nuclear verdicts often involve disproportionately large non-economic damages awards, the part of the award intended to reimburse the injured party for intangible losses such as pain and suffering. These damages are subjective and, unlike economic damages, are difficult to quantify, assess, or estimate. The recent trend of increasingly large non-economic damages awards has been the cumulative result of what is referred to as “social inflation”.

Social Inflation

Social inflation is generally described as how claims costs increase at a greater rate than general economic inflation. The definition is simple, but the factors contributing to social inflation are numerous, complex and interrelated.

Social Inflation's Interrelated Factors



Increasing
Propensity
to Sue



Size of Jury
Awards



Courts/Juries
Favoring
Plaintiffs



Growing
Distrust of
Large Corps.



Litigation
Financing



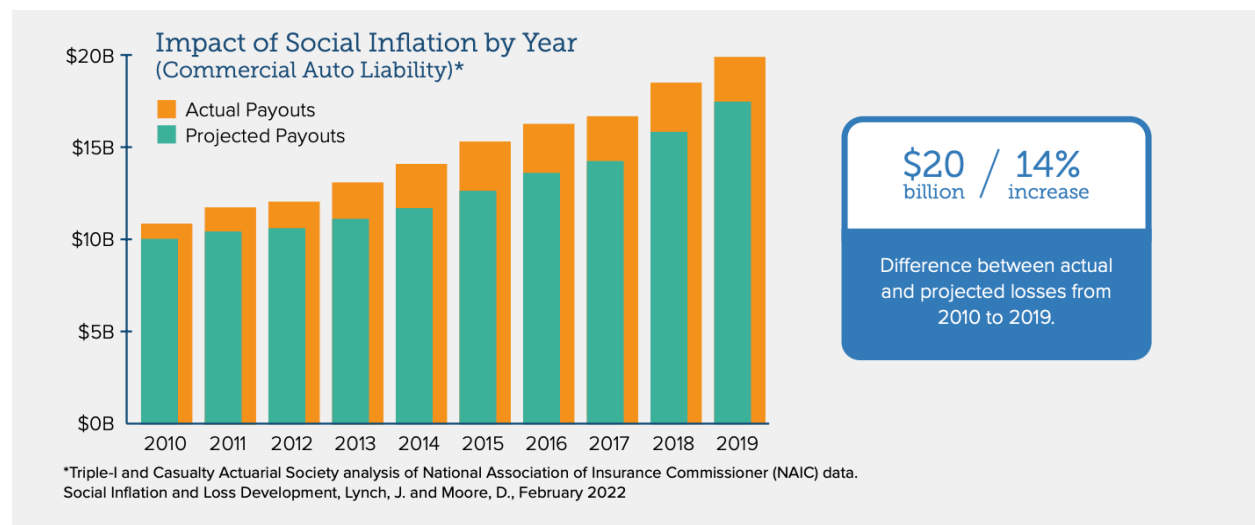
Aggressive
Plaintiff
Bar Ads



Changes in
Regulatory
and Legal
Environment

The aggressive advertising of plaintiff bars and changes in regulatory and legal environments are driving an increasing propensity for people to sue. A growing distrust of large corporations (along with government entities) combined with courts and juries favoring plaintiffs and wanting to punish those large corporations, lead to dramatically larger jury awards. The size of those awards makes it lucrative for third parties to finance plaintiff litigation, increasing the odds of even larger future awards. On and on it goes, leading to more and more nuclear verdicts.

As illustrated below (limited to commercial auto liability), the impact of social inflation is dramatic at an estimated \$20 billion in additional payouts.



The Plaintiff Bar

These increased payouts dramatically impact defendants as well as society (and for government agencies, ultimately the tax payers), but are a massive incentive for the plaintiff bar to keep seeking cases and pushing for larger and larger outcomes. We have all seen the billboards, heard the radio ads, and watched the commercials on television. *Been injured in an auto accident? Call 1(800) LAW-SUIT.* It is estimated that over \$3.4 billion is spent annually in the United States on legal advertising, the overwhelming majority on the plaintiff side. The next time you are driving down the highway, count how many law firm billboards you see. Or, when you are watching the morning news, pay

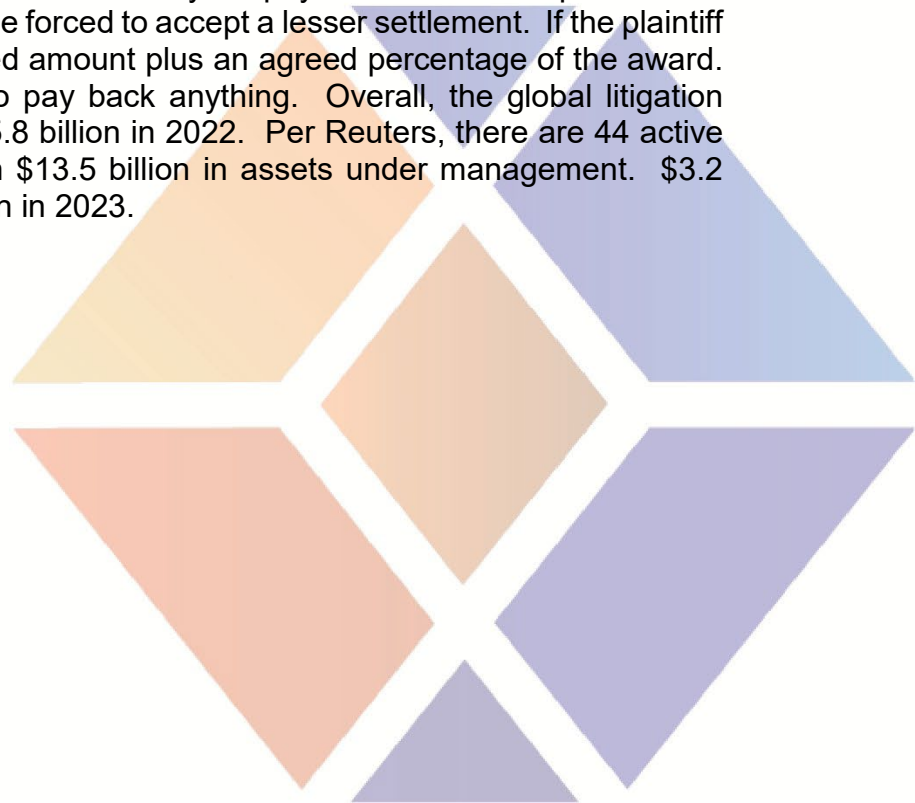
attention to how many law firm ads are shown. When you start paying attention to the volume, it really is astonishing.

Once this massive investment succeeds (a client has been acquired and a case is brought to trial), plaintiff attorneys implement numerous strategies to instill anger and/or fear in the jury with the goal of convincing them to protect and punish with outrageous punitive damages. The most famous and successful strategy used in recent years is called the “Reptile Theory”, which is used to influence a jury outcome by focusing the jury’s reaction to instinctively favor safety and survival of their families and community (versus plaintiff’s actual injuries) by demonstrating the defendant’s conduct endangers their families and community as a whole. It intentionally plays on the jurors’ fear that this could happen to them or theirs, and it’s up to them to do something about it by awarding a huge, punishing verdict.

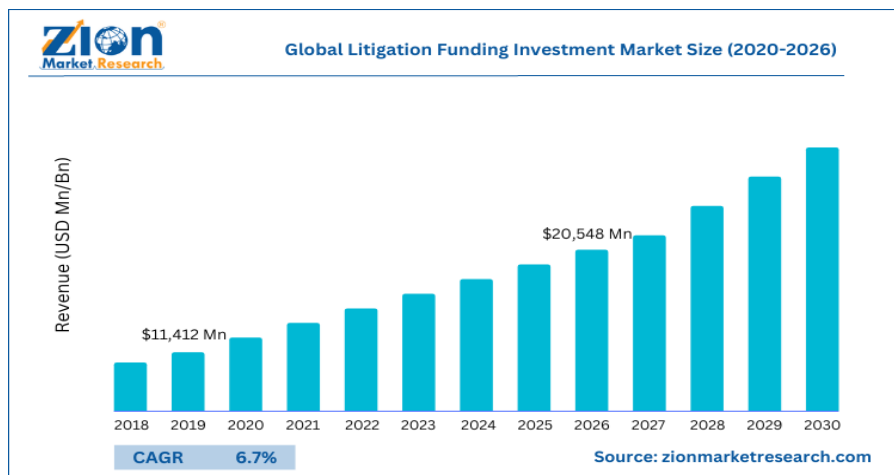
Another successful plaintiff bar tactic is known as “anchoring”. This involves talking about a desired (and astronomical) demand early and often throughout the trial causing the jury to become desensitized to the amount so that when that amount is demanded in closing arguments, it seems not only reasonable, but appropriate. For example, the plaintiff attorney may ask each prospective juror during the jury selection process if they would be comfortable awarding \$30M to the plaintiff if the defendant is found to be liable. They then discuss \$30M in each stage of the trial until, at the end, guess what the jury comes back with...a \$30M award! These are only two of a myriad of tactics and strategies used by the plaintiff bar to drive up the cost of claims outcomes.

Litigation Financing

With millions of dollars at stake, it is no wonder that speculators have gotten involved in the form of litigation financing. Otherwise known as “non-recourse financing”, investors put up large amounts of money to support plaintiff’s litigation efforts. The money is used to hire high-priced experts, fund additional investigation, and pay for expensive trial preparation. In some cases, it just provides money to “pay the bills” so the plaintiff can keep going and not drop the case or be forced to accept a lesser settlement. If the plaintiff wins, they must pay back the financed amount plus an agreed percentage of the award. If they lose, they are not required to pay back anything. Overall, the global litigation funding market was estimated at \$15.8 billion in 2022. Per Reuters, there are 44 active funders in the US market alone with \$13.5 billion in assets under management. \$3.2 billion was committed to fund litigation in 2023.



Litigation funding is a huge and growing industry, which right now is largely un-regulated. The arrangements are considered investments, not loans, so predatory lending caps do



not apply or are enforced. Worse, in most states, including California, the plaintiff's attorney is not required to disclose the arrangement to the jury. Unfortunately, as the adjacent chart illustrates, litigation financing is only expected to grow.

Jurisdiction

And then there is the jurisdiction within which we operate. Since 2002, The American Tort Reform Foundation's (ATRF) Judicial Hellholes® program has identified and documented places where judges in civil cases systematically apply laws and court procedures in an unfair and unbalanced manner, generally to the disadvantage of defendants. More recently, as the lawsuit industry has aggressively lobbied for legislative and regulatory expansions of liability, the Judicial Hellholes® report has evolved to include such lawand rule-making activity, much of which can affect the fairness of any given jurisdiction's civil justice climate as readily as judicial actions. Unfortunately, as shown below, in ATRF's annual ranking of the nation's worst jurisdictions, California has ranked in the bottom three (meaning the worst) jurisdictions for the last eight years.



Economic Impact

The impact of social inflation-driven costs on the insurance industry has been both obvious and dramatic. The impacts on society at large and the average citizen are also astounding. When excessive nuclear verdicts are awarded, they drive higher and higher claims settlements as defendants look to reduce their worst-case scenario, but at an ever-increasing price. The cycle continues as plaintiff attorneys follow the money soliciting more clients and developing more strategies to drive juries to award even larger verdicts. This has dramatically driven up the cost to the insurance industry and resulted in significantly higher premiums for all of us...the insurance consumers.

The economic impacts can be and are measured with horrifying results. Each year, billions of dollars of personal income are lost in California due to excess litigation costs. It's not only dollars, but estimates show that excessive litigation has also cost more than 750,000 Californians their jobs. One study calculated the "tort tax" paid by each Californian at \$2,120 per person, per year: the 3rd highest such figure in the nation.



The GL1 Program

Unfortunately, the GL1 Program members have experienced our fair share of large losses, contributing to the challenging conditions described above. In fact, over the ten-year period from 2012/13 through 2022/23, GL1 members have experienced 927 claims that exceeded their current self-insured retention (SIR). These claims collectively exceeded the collective SIRs by \$943M for an average of \$94.28M per year. Many members have raised their SIRs over that period, so the amounts actually incurred by the Program are even higher. The figures above are un-trended. It is important to note that insurance carrier underwriters and actuaries apply some trend 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, making the GL1 Program results significantly higher.

PRISM's Response

PRISM has always been proactive in managing the GL1 Program with our exposure and experience-based allocation approach to ensure an equitable distribution of costs amongst the members. In recent years, the Program has been loss challenged, causing some members to take on increased 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 (JPAs) in the nation to establish 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.

The organization has also hired staff to assist in reducing the overall cost of risk in many different areas. PRISM's claims staff works closely with members and their third party administrators (TPAs), to accurately reserve open claims and to develop strategies to resolve them as cost-effectively as possible. With the right facts and circumstances, this can mean taking the case to trial and achieving a defense verdict. Other times, it is more cost-effective to reach a settlement. PRISM members can rely on staff's expertise to assist in making these decisions. PRISM staff see large complex claims from all over the state and have relationships with complex claims resources at the carrier level. They are able to leverage this experience and expertise to assist in strategy, suggest expert witnesses and other resources, determine an appropriate case reserve, and advise on settlement negotiations.

PRISM is among the nation's few JPAs with internal actuarial staff and the only one we are aware of with its own Data Scientist. These specialized human resources leverage the massive volume of data that PRISM's Data and Analytics Department collects from the membership on a monthly basis to better predict future costs and identify loss trends. This trend identification allows PRISM's robust Risk Control and Member Services staff to tailor training and services to address problem exposures and developing member needs.

PRISM also takes an active role in legislature. The Legislative Committee works with their lobbyists to oppose legislation beneficial to the plaintiff's bar and support that which is helpful to the defense. In recent years, they have been successful in inserting immunities into numerous bills that otherwise would have created additional liability exposure for public entities. PRISM also works with other JPAs and associations to gather data to support legislative efforts.

Finally, PRISM and its broker, Alliant, have developed long-term relationships with excess insurance and reinsurance underwriters. They work throughout the year to not only maintain their participation on the Program in a very difficult claims environment, but also to analyze structural changes and other strategies to make the overall cost as efficient as possible. This can include changes in the layering of the Program to maximize the available carrier capacity as well as the prudent use of self-insurance in the pool layer and corridor deductibles, or PRISM quota share participation in the excess layers.

While PRISM's premiums will increase for 2024/25, 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 new members that join each year at considerable

price savings compared to their other stand-alone or JPA options. In addition to premium savings, these entities enjoy broader coverage and avoid coverage restrictions and limitations that are often quoted outside of PRISM.

Member's Response

There are several steps that can and should be taken by members 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. Manage your individual risk by taking advantage of the best practices programs and service partner programs we offer.
9. Support legislative change beneficial to defendants.
10. Help educate the public that the costs of nuclear verdicts are not borne by the insurance industry, but rather by public entities and ultimately the taxpayers.

The importance of #10 cannot be stressed enough. When members have high-value claims settle or awarded by verdict, it can be tempting to comfort constituents by letting them know "we're covered by insurance". However, the public won't ever truly understand the magnitude and impact of social inflation and nuclear verdicts if entities aren't forthright in acknowledging that these do in fact cost the entity, and ultimately the taxpayer, a lot of money.

Last, but not least, PRISM Risk Control staff 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:

PRISM's General Liability Risk Control Resources

PRISM offers direct consultation from staff and access to over 40 master service agreements. Below are services directly correlated to liability risk:

- *PRISM members are provided free access to [Labor Law/Employment Practices Services](#) through Eyres Law Group (ELG). 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, [Plexus 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 as well as 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

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 more 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 130 members, more than \$8.4B in payroll and 703,000 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 and Anchoring) 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 every year. 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.