

Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

DISCUSSION ITEM

For Meeting of January 25, 2017

UPDATE ON FIAT LUX CAPTIVE INSURANCE COMPANY

Fiat Lux Risk and Insurance Company is a wholly-owned, single-parent, not-for-profit captive insurance company established by the Regents of the University of California in 2012. As an incorporated and licensed insurance company, Fiat Lux provides the University a unique mechanism with which to finance UC's systemwide risks. It also allows UC the ability to capture underwriting profits and corresponding investment income that would normally be retained by traditional insurance companies by becoming a risk-bearing insurer itself.

Fiat Lux now purchases a majority of the insurance to cover the University's risks systemwide. Where in the past UC purchased this insurance "retail" through brokers, now Fiat Lux purchases reinsurance directly from the markets (wholesale). This increases UC's capacity and reduces its expense.

Executive Vice President and Chief Financial Officer Brostrom and Associate Vice President and Chief Risk Officer Cheryl Lloyd will provide an update on Fiat Lux's activities to date and future opportunities.

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 UC Regents, who are also its principal beneficiary. While the captive insurance company is a separate legal entity subject to corporate formalities, its owner (e.g., UC Regents) has direct involvement in and influence over the captive's major operations, including underwriting, claims management, policy form, and investments.

There are more than 5,000 captives domiciled throughout the world today and between 40 percent and 50 percent of major U.S. corporations utilize them, including many major university-affiliated health systems. Over 1,000 higher education institutions own or participate in captive insurance structures in the United States alone. Prominent among these universities and colleges are the University of Minnesota, Yale, Stanford, Duke, Northwestern, Pennsylvania State University, the University of Michigan, Rutgers, Cornell, and Columbia.

A captive insurance company can yield the following benefits:

- Because it is a self-insurance vehicle, the captive is not subject to the wide swings of a commercial insurance pricing and therefore use of a captive can improve cost stability and predictability.
- Captive insurance companies are held to rigorous external accounting and auditing standards, which compel formalized risk financing policy and practice.
- Because it is licensed insurance company, a captive insurance company can directly access the reinsurance markets. In essence, it allows UC to purchase excess insurance (reinsurance) on a wholesale basis as opposed to retail. This can increase the number of reinsurance companies available to compete for U.C. business.
- A captive would facilitate the provision of insurance to non-UC organizations (third parties such as affiliated physicians or joint ventures).

UC's Captive, Fiat Lux, via Regental approval granted in 2012 also has the ability and authority to create additional captives. The Board of Directors of Fiat Lux Risk and Insurance Company, in conjunction with the President and the General Counsel, decided to pursue the formation of a second captive insurance company focused on the medical malpractice risks of non-employed physicians. The construct of the captive is in the form of a Reciprocal Risk Retention Group.