HIGHER EDUCATION FACES A PERFECT STORM

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Higher Education

Understanding the drivers of liability claims frequency and severity, and how risk managers should be responding.

Key highlights

- More institutions reached preliminary settlement agreements after more than a year of litigation regarding a federal antitrust lawsuit against 17 elite universities.[1]
- According to the *Campus Climate Survey on Sexual Assault and Misconduct,* the rates of sexual assault have increased slightly over the past few years.[2] Higher education institutions and K-12 schools continue to experience losses related to sexual assault and misconduct, accounting for roughly 25% of all claim costs over the past few years.[3]
- Three prominent university presidents were publically criticized during a congressional hearing to of their handling of student activism surrounding the Israel Gaza conflict.[4] Two of the three leaders resigned following the hearing.
- Social inflation — the increase in indemnification costs (settlements and jury verdicts) above general economic inflation — has significantly impacted the past five to six years, drastically increasing the severity of claims.[5]
- In February 2024, President Biden announced the approval of $1.2 billion in student debt cancellation for almost 153,000 borrowers currently enrolled in the Saving on a Valuable Education (SAVE) repayment plan.[6]

Introduction

The onslaught of higher education in national media headlines seems to be never-ending the last few years. Larger claims settlements and the public's perception of higher education in general are impacting university operations and budgets. This perfect storm of event-driven litigation, lowering public perception of the value of education and trust in the industry, social inflation, and the growing complexity of educational institutions' risk profiles are among the factors shaping exposures moving forward.

Among the trends impacting educators' legal liability (ELL) are:

- Sexual harassment and discrimination lawsuits
- The ongoing antitrust and price fixing litigation
- A plaintiff's bar that is hyperfocused on higher education
- Fraud/Due process
- Sexual misconduct (including both employee and student Title IX claims)
- Wrongful termination
- Discrimination
- Breach of contract

Meanwhile, the commercial insurance market that covers these risks is becoming increasingly constrained. Against heightened claims severity, carriers are introducing a raft of exclusions, reducing capacity, and insisting that insureds have more "skin in the game" in the form of higher retentions.

With a hardening market, buyers are considering more innovative solutions. This includes exploring alternative ways to financial risk, such as captive insurance and carrying out scenario analysis to stress-test how their coverage might respond if and when a significant loss occurs. Such exercises can help to identify gaps in coverage and uncover areas of vulnerability requiring attention.

What is ELL insurance?

ELL insurance is designed to cover a broad range of non-bodily injury and non-property damage liability claims made against the boards, administrators, and employees of educational institutions.[7]

ELL, which is also known as "school board legal liability insurance," is a hybrid of traditional Directors & Officers (D&O) and Errors & Omissions (E&O) coverages. Typical claims covered by ELL include discrimination, retaliation, wrongful termination, failure to grant tenure, and failure to educate.

Case study: Elite universities accused of price fixing

Background: In January 2022, a group of plaintiffs filed a class-action lawsuit against 17 prestigious universities. The lawsuit claimed these institutions had engaged in an illegal cartel by colluding on financial aid formulas. According to the plaintiffs, this resulted in thousands of middle-class and working-class students paying too much for their education.

Key points:

- The universities allegedly collaborated on financial aid formulas while supposedly following an antitrust exemption that allowed them to discuss such matters without violating antitrust laws.
- Plaintiffs claim the universities went beyond the exemption and considered family finances in admissions decisions, potentially offering preferential treatment to the children of wealthy donors.

Settlements:

- As of February 2024, ten of the 17 original universities targeted by the class action have settled the lawsuit for $284 million. Negotiations between lawyers representing the remaining seven universities were ongoing at the time of writing.[9]

Legal considerations:

Under US antitrust law, higher education institutions can collaborate on financial aid awards if they do not consider a student's ability to pay tuition when deciding whether to accept them. This practice is known as "need-blind" admission.

The lawsuit alleges that the accused universities either failed to adhere to need-blind admission or colluded with other schools in setting financial aid awards, thereby reducing price competition and disadvantaging students needing financial aid.

The makings of a perfect storm

Several factors have led to increased litigation against higher educational institutions in recent years, and a trend toward significantly higher legal awards. These include:

- **Deep pockets and complex risks:** Larger universities are often targeted in lawsuits due to their assets. This has earned them the reputation as institutions with deep pockets, which can afford to pay substantial settlements. Higher educational institutions have an increasingly diverse business model and engage in activities beyond traditional education,[10] such as mergers and acquisitions and investments in new ventures. These complexities further complicate their risk profile, requiring robust risk management strategies that some institutions may need to improve.

"Higher education institutions are often large and complex organizations that go beyond just providing education for tuition. They have robust balance sheets and they often have significant healthcare exposures embedded in their organization. Recognizing these institutions are much more complex than what meets the eye is essential. As such, a comprehensive understanding of their operations is required to navigate higher education institutions' legal implications and insurance needs."

John Ergastolo, Area Executive Vice President, GGB US — GSP Management Liability, Gallagher

- **Lagging corporate governance:** Because universities were traditionally set up as seats of learning, in shared governance between faculty, administrators, and trustees is commonplace. As the roles and activities of an institution of higher education expand to include, research, healthcare and other ventures, it's prudent to evaluate its current framework for institutional governance and oversight. The evolution of universities' roles and activities has outpaced the development of their corporate governance frameworks, potentially exposing them to increased litigation risks.
- **Shifting funding models:** Traditionally, universities relied heavily on tuition fees, appropriate funds, and auxiliary enterprises as their primary funding source. However, the trend of securing funds through donations and grants, corporate partnerships and sponsorships has added a further layer of complexity. This shift in funding models can impact universities' ability to effectively manage risk as they navigate the complexities of donor expectations and compliance requirements. The reliance on external funding sources introduces potential challenges in risk management and may contribute to increased litigation against higher educational institutions.
- **Social inflation:** Refers to the growing tendency for juries to award more considerable monetary damages to plaintiffs in civil litigation cases.[11] Various factors, such as changing societal attitudes, perceptions of corporate wrongdoing, and a general increase in the cost of litigation, have influenced this phenomenon. In the context of higher education, heightened awareness of issues such as discrimination, harassment, and misconduct can drive social inflation. In cases where juries perceive that an institution has failed to address victims' concerns adequately, they may be more inclined to award substantial damages.

"It is concerning to note the impact of social inflation on our clients, as they have to spend significant amounts of money on covered and uncovered claims, particularly defense costs. The expenses associated with antitrust claims can be pretty staggering, with some clients spending as much as $1 million per month on defense costs alone. Considering the risk and financial implications of defending against such claims is essential for higher educational institutions as they consider their insurance and other risk financing requirements."

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- **Event-driven litigation:** Refers to lawsuits that arise in response to specific incidents or controversies. In the case of higher education, issues such as discrimination, sexual harassment, antitrust violations, and other forms of misconduct can attract significant legal scrutiny.[12] These cases often garner media attention and public scrutiny, encouraging affected individuals or advocacy groups to pursue legal action. Moreover, the increased visibility of these issues can lead to greater public awareness and scrutiny of institutional policies and practices, potentially exposing institutions to additional legal risks.

A constrained ELL insurance market

In the realm of ELL insurance within the higher education sector in the US, a notable shift is occurring. Despite rising liability risks[13] and increasing demand for insurance coverage, ELL insurance carriers are becoming more cautious about extending coverage to higher education institutions.[14] This caution is driven by an uptick in claims frequency and severity, and results in a constrained ELL insurance market.

Current market dynamics for ELL are driven by the following trends.

- **Increased liability exposures:** Various liability risks expose higher education institutions to claims related to employment practices, including lawsuits filed by faculty or staff members for wrongful termination or discrimination. In addition, student grievances, such as allegations of academic misconduct, discrimination, and/or harassment, can result in legal action against the institution. Other potential sources of litigation may arise from negligence, such as the failure to provide a safe learning environment, breach of contract, and intellectual property disputes. Institutions must take steps to minimize their exposure to legal action through effective risk management strategies and effective corporate governance.
- **Declining carrier appetite for risk:** Insurance companies are reevaluating their willingness to underwrite risks for higher education institutions, partly due to the increasing frequency and severity of claims in this sector. At the same time, broader market conditions are influencing how much coverage insurers are willing to offer. Meanwhile, regulatory changes, including shifts in legislation related to Title IX or employment laws, are also impacting carriers' perceptions of risk in higher education. As a result, institutions in this sector need to be more proactive in managing their risk profiles and exploring alternative risk financing options, such as captive insurance.
- **Rising costs and restrictions:** As insurance carriers become more risk averse, they may increase premiums for ELL coverage to compensate for the perceived higher risk. Moreover, insurers may impose stricter underwriting criteria to minimize their exposure to potential losses and include more exclusions in their policies. These rising costs[15] and restrictions impact the amount and extent of coverage higher education institutions are able to secure at renewal, potentially leaving them underinsured for certain liabilities.
- **Tighter terms and conditions:** As mentioned, insurance carriers are increasingly imposing tighter terms and conditions in ELL policies, which can leave certain types of claims uncovered or require more stringent conditions for coverage. For instance, carriers may include exclusions for specific types of claims, such as those related to cyber liability or acts of terrorism. Policy limits and deductibles may also be adjusted, further limiting the institution's financial protection. To ensure adequate protection in case of a claim, educational institutions should review the terms and conditions of their ELL policies carefully.

Considering all the options: Having more “skin in the game”

Due to the increasing number of lawsuits, substantial increase in jury awards, and the constrained commercial insurance market, higher education institutions may need to explore more options when it comes to securing comprehensive ELL coverage. This may include alternative risk transfer strategies, such as forming captive insurance companies or cell captives to self-insure and retain some ELL risks. However, these options may require significant financial resources and risk management maturity.

Benefits of taking more risk

Taking on more risk can be a powerful incentive for an institution to prioritize its practices relative to risk management, governance and oversight. Institutions that are exploring alternatives should perform a broad assessment to evaluate: governance and financial capacity to retain more risk; operations and exposures; claims experience over a minimum of 10 year period; opportunities for manuscripting coverage to align with operations and the appropriate attachment point for commercial insurance.

By adopting a proactive approach to risk management, these institutions can also enhance their reputation and credibility, making them more attractive to students, faculty, and donors. This can help them stand out in today’s competitive higher education landscape. By actively managing their risks and implementing effective risk mitigation strategies, these institutions can significantly reduce the likelihood of costly liability claims and, in turn, strengthen their financial stability.

Negotiating power

Institutions willing to take on more risk may have an advantage when negotiating their ELL renewals. By demonstrating a commitment to risk management and the ability to mitigate potential liabilities effectively, institutions can secure more favorable terms. Insurance carriers are more likely to view institutions with a robust claims track record more positively, which can increase their access to insurance markets and potentially lower their overall insurance costs over time.

A risk management sea change

Higher educational institutions in the US are experiencing a significant transformation in their approach to risk management due to various challenges they face, including heightened liability exposures and a more challenging insurance market. Consequently, these institution and its risk management practices must reevaluate their risk management strategies and how they finance those risks.

As a result of changing demands, a growing number of higher educational institutions are taking a more forward-thinking and strategic approach to risk management and governance best practice. An increasing number of institutions proactively presenting comprehensive renewal submissions that highlight the strengths of the institution and its risk management practices for insurance coverage is evidence of a departure from traditional reactive approaches. However, there is still ground to cover.

Moreover, there is a growing recognition within the industry that adhering to basic compliance frameworks, often called "safe harbor" approaches, is no longer sufficient or fit for purpose. There is a realization that clients must adopt more comprehensive and robust corporate governance practices, including proactive measures to effectively identify, assess, and mitigate risks before they become full-blown legal problems.

This sea change in risk management signifies a departure from more conventional reactive and compliance-driven approaches to risk and governance toward a more proactive, strategic, and holistic stance. It reflects a growing awareness among higher education institutions of the need to adapt to a rich and rapidly evolving risk landscape, and to take proactive steps to protect their interests and stakeholders.

Conclusion: A good defense is the best offense

ELL is firmly on the boardroom agenda, with a growing recognition that higher education will remain a target for liability claims for the foreseeable future. Safe harbor compliance frameworks are no longer adequate as a defense, and the onus is on institutions to continuously improve controls and frameworks around corporate governance as they attempt to keep up with the evolving landscape.

A shift is happening as risk and insurance managers navigate a raft of changing exposures and a more challenging insurance market. The approach within higher education is becoming more proactive, and risk financing strategies are becoming more sophisticated and nuanced, with clients willing to take more risk on their balance sheets, using captives and other alternative risk finance methods, and better manage their exposures moving forward in a more litigious and uncertain environment.

The challenges outlined in this whitepaper are universal among higher educational institutions. While large notable institutions are currently the focus of numerous lawsuits affecting the market trends we discuss, other types of educational institutions should not consider themselves immune from similar liability trends in the future.

Carrying out an audit of where the gaps in insurance coverage are, identifying any weaknesses in compliance controls, and keeping abreast of the latest legal trends will pay dividends moving forward in this market.

Citations

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