Los Angeles County
Metropolitan Transportation
Authority
One Gateway Plaza
3rd Floor Board Room
Los Angeles, CA

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FINANCE, BUDGET AND AUDIT COMMITTEE
APRIL 20, 2022

SUBJECT: PROPERTY INSURANCE PROGRAM

ACTION: APPROVE RECOMMENDATION

RECOMMENDATION

AUTHORIZE the Chief Executive Officer to negotiate and purchase All Risk Property and Boiler and Machinery insurance policies for all property at increased policy limits at a not to exceed price of $5.5 million for the 12-month period May 10, 2022 through May 10, 2023.

ISSUE

The All Risk Property and Boiler and Machinery insurance policies expire on May 10, 2022.

BACKGROUND

Our insurance broker, USI Insurance Services ("USI") is responsible for marketing the property insurance program to qualified insurance carriers. Quotes are currently being received from carriers with A.M. Best ratings indicative of acceptable financial soundness and ability to pay claims. The premium indications below are based upon current market expectations. Final pricing, however, is not available until approximately 30 days prior to binding coverage.

Metro established a program of Excess Commercial Property Insurance to protect against insured losses. Each year, Risk Management meets with USI to prepare for the upcoming marketing process and secure the data required to approach underwriters and obtain the most competitive coverage and pricing available.

Initial discussions begin in the first quarter of the fiscal year through an evaluation of market conditions to determine the availability of coverages and what levels of premium are indicated. Once established, an annual stewardship meeting is conducted in September to review what data will be required, including new infrastructure, such as rolling stock (bus, rail and non-revenue vehicles), real property (buildings and facilities), business personal property (equipment, furniture) and newly completed projects as each are accepted by the agency. Risk Management further obtains status data including targeted completion dates of various projects to provide an accurate account of the present and future property exposures within the agency.

Risk Management compiles updated information including projected revenues, payroll, property valuations and property distribution as needed. Once internal data is collected, the data forwarded to USI to present to the domestic insurance marketplace as well as international markets in London, Bermuda and Amsterdam. Due to timing requirements, USI approaches underwriters in January to ensure that data is deemed current. Initial indications of interests and costs generally become apparent in late March.

USI provides a not-to-exceed number that serves two functions. First, the number provides an amount that Risk Management may approach the CEO and Board to obtain approval for binding of the new program, which mitigates a potential gap in insurance coverage. And second, the number allows our broker ample time to continue to negotiate with underwriters to ensure that Metro obtains the most competitive pricing available.

DISCUSSION

Property insurance protects against losses to our structures, fleets, and improvements, which are valued at approximately $14.6 billion, up from last year's $13.6 billion. The increase in total insured value is primarily due to general replacement cost growth (mainly soaring construction costs) along with revaluation of both heavy and light rail vehicles. The value of the Crenshaw/LAX Line was previously included in our total insured values last renewal and the property is fully insured. Property insurance is required by many contracts and agreements, such as our lease/leaseback deals involving a number of our operating assets.

USI marketed the property program to qualified insurance carriers to obtain property insurance pricing with coverage limits of $425 million. Quotations for our property insurance program were received from carriers with acceptable A.M. Best ratings. Final pricing is pending, so the quotes including contingency for unanticipated adjustments serve as a not to exceed cost before policy binding.

The Recommended Program secures the All Risk deductible at $250,000 with no earthquake coverage and a flood deductible at 5% per location subject to a $250,000 minimum. USI continues negotiations with carriers regarding deductible limits on selected Metro assets including rolling stock, non-revenue vehicles and potential flooding in subway tunnels. If a loss exceeds the deductible, All Risk coverage is provided up to $425 million per occurrence for losses except for flood related damages that are covered up to $150 million (tunnels are covered up to $50 million with a $500,000 deductible for flood damages). The recommended program is the same as the prior year program. Attachment A shows the outline of the recommended program structure. The not to exceed premium price includes a contingency for premium adjustments, taxes and fees due to on-going negotiations with insurance carriers.

The recommended program does not include earthquake coverage. We received quotes estimated at $4.2 million for $50 million in limits with a 5% of total insured value deductible. Metro has not purchased earthquake coverage in previous years. In the event of a major disaster, we believe funding would be available through federal and state sources to restore public transportation in Southern California. The lack of earthquake coverage is consistent with decisions made by other large local government agencies.

We evaluated terrorism coverage options this renewal cycle and have not opted to purchase the coverage. Terrorism coverage is available but does not appear to be cost effective at a quoted cost of $687,700 for $400 million limits with a $50,000 deductible. The Terrorism Risk Insurance Act (TRIA) provides government support by providing mechanisms for spreading losses across policyholders. In the past, we rejected this coverage because of the high likelihood of federal and state funding to restore transportation services as a result of a serious terrorism incident. We will continue to reject terrorism coverage at the present time.

The current and recommended programs of insurance are layered structures. Several insurance carriers participate in the program with each contributing a portion of coverage which maintains a diversified portfolio of insurance carriers. Continual monitoring through internal methods, as well as updates provided by USI, ensure that all carriers maintain the required financial ratings indicated by financial reporting agencies and as determined by A.M. Best.

In January, February, and March 2022, USI contacted multiple domestic and international insurance providers to present our property risks and supplemental data. USI provided an overview of the Metro transit system during discussions with the underwriters, including our extensive security infrastructure, fire protection, loss control and minimal risk of flood exposures. USI provided information and statistics on system operations, assets, and our excellent loss history over the past twenty years with one fixed property insurable event and under $1.8 million insurable losses of rolling stock and non-revenue vehicles.

The Metro property program continues to be well received by insurers due to our favorable loss history and the growth of the account from $7.8 billion in values in 2010 to $14.6 billion for this renewal. As such, USI presented the submission to incumbent and competing insurers to create competition in the insurance marketplace. The marketing effort resulted in maintaining our incumbent carriers for the recommended program. Our rate per million dollars of insurable value is $377 for the recommended program which represents a 15.4% rate increase per million dollars of insured value over the prior year. Some of the major factors driving the rate increase are summarized in the following paragraphs.

The property insurance market is continuing to experience major interruption. Capital (and therefore capacity) has either been exhausted or withdrawn from the market in a way that has not been seen since 2001. Losses over the past six years continue to show higher than expected loss development. In 2020, many carriers pulled out of unprofitable classes of business. This year, carriers are looking at those classes again if the rate and terms are deemed adequate. Carrier One Beacon exited the public entity space in March 2022 leaving a void of $80 million in coverage for public entities.

Commercial property insurance rates have shown significant growth in recent quarters. Climate change’s influence on natural catastrophes, supply chain challenges and inflation are working concurrently to push rates higher, according to a report from Westchester, Chubb Ltd.’s wholesale excess and surplus lines division. In addition to driving up rates, the issues are making underwriting more challenging. Further, inflationary pressures along with rising costs for labor and building materials are increasing the possibility for undervalued replacement costs. Carriers are looking to return their portfolios to profit which has led to continuing universal rate increases (even for insureds that are claims-free).

According to the Allied Public Risk “Public Entity Insurance Market Outlook for 2022” report, the demand on insurance carriers to deliver profits, the limited participants in the public entity market, and inflationary pressures on operational and claims expense contribute to increased premiums throughout 2022. As operational and claim costs increase, premiums are adjusted to cover anticipated liabilities to deliver acceptable profit margins. The limited number of carrier participants in the public entity market compounds the costs associated with losses and operations. Over the last 18 months, several carriers have exited the public entity sector because of rising risks and falling profits. Carriers that remain in the market are either reducing limits or requiring higher Self-Insured Retentions but are offering no premium reduction in return.

Along with premium increases and higher deductibles, carriers are instituting more restrictive terms. Carriers are rating on the potential for loss (regardless of good loss history) and with our increased valuations on buildings, facilities, buses and rail cars, carriers are rating on total loss estimates. Many carriers are reducing their capacity by 20%-50%, in some cases requiring more carriers to participate on programs in order to maintain limits. For this renewal, our broker was able to retain last year’s incumbent carriers.

Metro has enjoyed some of the lowest rates among transit systems and remains an attractive client within this space. Unfortunately, the space is not held in the same regard it was just a few years ago. This year’s renewal reflects our continuing favorable insurability and ability to take full advantage of USI’s marketing efforts in a very demanding market environment.

DETERMINATION OF SAFETY IMPACT

Approval of this procurement will not impact the safety of Metro's patrons or employees.

FINANCIAL IMPACT

The funding for two months of $916,667 for this action is included in the FY22 Budget in cost center 0531, Risk Management - Non Departmental Costs, under projects 100001 - General Overhead, 300022 - Rail Operations - Blue Line, 300033 - Rail Operations - Green Line, 300044 - Rail Operations - Red Line, 300055 - Gold Line, 300066 - Expo Line, 301012 - Metro Orange Line, 306001 - Operations Transportation, 306002 - Operations Maintenance, 320011 - Union Station, and 610061 - Owned Property in account 50601 (Ins Prem For Phys Damage). In FY22, an estimated $4.6 million will be expensed for property insurance.

The remaining ten months of premiums are included in the FY23 Requested Budget, cost center 0531, Risk Management - Non Departmental Costs, under projects 100001 - General Overhead, 300022 - Rail Operations - Blue Line, 300033 - Rail Operations - Green Line, 300044 - Rail Operations - Red Line, 300055 - Gold Line, 300066 - Expo Line, 301012 - Metro Orange Line, 306001 - Operations Transportation, 306002 - Operations Maintenance, 320011 - Union Station, and 610061 - Owned Property in account 50601 (Ins Prem For Phys Damage).

Impact to Budget

Additional funds required to cover premium costs beyond FY23 budgeted amounts will be addressed by fund reallocations during the year. The current fiscal year funding for this action will come from the Enterprise, General and Internal Service funds. No other sources of funds were considered for this activity because these are the funds that benefit from the insurance. This activity will result in a minor change to operating costs from the prior fiscal year.

EQUITY PLATFORM

Metro's property insurance program ensures that our facilities, rolling stock fleet, and infrastructure are covered by insurance policies in the event of a major loss or damage. The insurance policies cover all Metro-owned property, stations, tunnels, bridges, rolling stock fleet, right of ways, facilities, and buildings that provide transportation service and benefits to low-income residents, black, indigenous, and people of color, people with disabilities, people with limited English proficiency, minorities, women, disadvantaged or disabled veterans, LGBTQ community, and other marginalized groups.

IMPLEMENTATION OF STRATEGIC PLAN GOALS

The recommendation supports strategic plan goal # 5 "Provide responsive, accountable and trustworthy governance within the LA Metro organization." The responsible administration of Metro's risk management programs includes the use of insurance to mitigate large financial risks resulting from damage to or loss of Metro property.

ALTERNATIVES CONSIDERED

The current program, the recommended program and an option with earthquake coverage are summarized in Attachment B. Based upon our past history of favorable renewal and losses, we recommend continuing the current program of insurance as the most cost effective and prudent program. The option of adding earthquake coverage is not recommended because the high cost of the earthquake premium does not justify the benefit of the coverage.

NEXT STEPS

Upon Board approval of this action, we will advise USI to proceed with placement of the property insurance program outlined herein effective May 10, 2022.

ATTACHMENTS

Attachment A - Recommended Pricing and Carriers
Attachment B - Alternatives Considered

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