



Board Report

File #: 2023-0013, File Type: Program

Agenda Number: 11.

FINANCE, BUDGET, AND AUDIT COMMITTEE APRIL 19, 2023

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 Metro properties at a not to exceed premium of \$8.5 million for the 12-month period May 10, 2023, through May 10, 2024.

ISSUE

The All Risk Property and Boiler and Machinery insurance policies expire on May 10, 2023.

BACKGROUND

Metro's insurance broker, USI Insurance Services ("USI"), is responsible for marketing the property insurance program to qualified insurance carriers. In this challenging hard market, quotes are currently being received from, and negotiations are ongoing with, carriers with A.M. Best ratings indicative of acceptable financial soundness and ability to pay claims. Premium indications are based on current market expectations. Final pricing, however, is not yet available as USI continues to broker the most competitive pricing for Metro.

Metro established a Excess Commercial Property Insurance program 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 premium 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 premium levels 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 the agency accepts each. Risk Management obtains status data, including targeted completion dates of various projects, to provide an accurate account of the agency's present and future property exposures.

Risk Management compiles updated information, including projected revenues, payroll, property valuations, and property distribution, as needed. Once internal data is collected, the data is forwarded to USI for presentation to the domestic insurance marketplace as well as international markets in London, Bermuda, and European markets. Due to timing requirements, USI approaches underwriters in January to ensure that data is current. Initial indications of interest 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 utilize to approach the CEO and Board to obtain approval for the 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 structures, fleets, and improvements, which are valued at approximately \$18.8 billion, up from last year's \$14.6 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. In addition, the Regional Connector Project, scheduled for final acceptance and operations during the upcoming policy term, has been included in the overall statement of values. The inclusion ensures that no gaps in protection occur during the transition into revenue operations. Property insurance is also required by many contracts and agreements, such as our lease/leaseback deals involving several of Metro's operating assets.

USI marketed the property program to qualified insurance carriers to obtain property insurance pricing with Probable Maximum Loss (PML) coverage limits at a minimum of \$450 million. Property insurance program quotations are currently being received from carriers with acceptable A.M. Best ratings. Final pricing is pending, and the quotes, including contingencies for unanticipated adjustments, serve as a not to exceed cost before policy binding.

The current property program includes an All Risk deductible of \$250,000 with no earthquake coverage and a flood deductible of 5% per location, subject to a \$250,000 minimum. USI continues negotiations with carriers regarding deductible limits and selected Metro assets, including rolling stock, non-revenue vehicles, and potential flooding in subway tunnels. Under the current program, if a loss exceeds the deductible, All Risk coverage is provided up to \$450 million per occurrence for losses except for flood related damages that are covered up to \$150 million (tsunami and tunnels are covered up to \$50 million with a \$500,000 deductible for tsunami and flood damages). Therefore, authority for the upcoming property renewal program is requested to continue negotiations with carriers for a minimum of \$450 million in coverage limits and a not to exceed deductible of \$1 million. Attachment A shows the outline of the renewal program structure within the parameters requested. The not to exceed premium price includes a contingency for premium adjustments, taxes, and fees due to ongoing negotiations with insurance carriers.

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.

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 due to a serious terrorism incident. We will continue to reject terrorism coverage at the present time.

The current and recommended renewal programs of insurance are layered structures. Several insurance carriers participate in the program, with each contributing a portion of coverage that 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 2023, USI contacted multiple domestic and international insurance providers to present Metro's property risks and supplemental data. USI provided an overview of the Metro transit system during discussions with the underwriters, including its extensive security infrastructure, fire protection, loss control, and minimal risk of flood exposures.

The Metro property program continues to be well received by insurers due to its favorable loss history and the account's growth from \$7.8 billion in value in 2010 to \$18.8 billion for this renewal. USI presented the submission to incumbent and competing insurers to create competition in the insurance marketplace. Incumbent carriers were maintained but at reduced participation, requiring additional carriers to be added to the program. Due to the current hard market, Metro's estimated renewal rate and premium are expected to increase significantly. The major factors driving the rate increase are summarized in the following paragraphs.

The property insurance market continues to experience major interruptions. Capital (and therefore capacity) has either been exhausted or withdrawn from the market with little new capital added.

Commercial property insurance rates continue to show significant growth over several quarters. The influence of climate change 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. Gallagher Re further projects that rates will increase from 35% to 50% for loss free property programs. In addition to driving up rates, these issues make underwriting more challenging. Further, inflationary pressures, along with rising costs for labor and building materials which current supply chain issues have exacerbated, are increasing the possibility for undervalued replacement costs. Lastly, hurricane Ian capped an already unprofitable year with an estimated \$120 billion of losses.

Carriers are looking to return their portfolios to profit, which has led to continuing universal rate increases even for insureds that are claims-free. Along with premium increases and higher deductibles, insurers are instituting more restrictive terms. Carriers are rating on the potential for loss (regardless of good loss history), and with Metro's increased valuations on buildings, facilities, buses, and rail cars, carriers are rating on total loss estimates. Many carriers continue to reduce their capacity by 20% to 50%, in some cases requiring more carriers to participate in insurance programs

to maintain limits. During this renewal, Metro's insurers are also taking losses on the recent severe weather, flooding, and, most recently, train derailments in Ohio.

Metro has historically 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, and carriers continue to reduce their appetite for transit risks. This year's renewal is especially challenging, but Metro's favorable insurability and ability to take full advantage of USI's marketing efforts in a very demanding market environment places Metro at an advantage compared to other transit agencies in the country.

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 \$1,416,667 for this action is included in the FY23 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 FY24, an estimated \$7.1 million will be expensed for property insurance.

The remaining ten months of premiums are included in the FY24 Preliminary 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, 300077 - Rail Operations - Crenshaw/LAX (K) 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 FY24 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 an increase in operating costs from the prior fiscal year.

EQUITY PLATFORM

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. Metro's property insurance program ensures that its facilities, rolling stock fleet, and infrastructure, which serve these groups, are covered by insurance policies in the event of a major loss or damage. Valuation of these assets, including assets in Equity Focus Communities, conforms to the insurance industry's replacement cost methodology.

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 using insurance to mitigate large financial risks resulting from damage to or loss of Metro property.

ALTERNATIVES CONSIDERED

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

NEXT STEPS

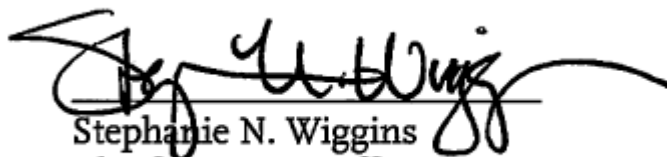
Upon Board approval of this action, we will advise USI to proceed with the placement of the property insurance program outlined herein, effective May 10, 2023.

ATTACHMENTS

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

Prepared by: Claudia Castillo del Muro, Executive Officer, Risk Management, (213) 922-4158
Kenneth Hernandez, Deputy Chief Risk, Safety, and Asset Management Officer,
(213) 922-2990

Reviewed by: Gina L. Osborn, Chief Safety Officer, (213) 922-3055



Stephanie N. Wiggins
Chief Executive Officer