



## Board Report

File #: 2024-0012, File Type: Program

Agenda Number: 5.

### FINANCE, BUDGET AND AUDIT COMMITTEE APRIL 17, 2024

**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 \$10.2 million for the 12-month period of May 10, 2024, through May 10, 2025.

#### **ISSUE**

The All Risk Property and Boiler and Machinery insurance policies expire on May 10, 2024.

#### **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, negotiations are ongoing to ensure placement with carriers that maintain acceptable A.M. Best ratings indicating financial soundness and the 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 the Excess Commercial Property Insurance program to protect against insured losses. Each year, Risk Management collaborates with USI to prepare for the upcoming marketing process, 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. Risk Management obtains status data, including targeted completion dates of various projects, to accurately account the agency's present and future property exposures.

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As needed, Risk Management compiles updated information, including projected revenues, payroll, property valuations, and property distribution. Once internal data is collected, the data is forwarded to USI for presentation to the domestic insurance marketplace and international markets in London, Bermuda, and Europe. 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. Second, the number allows our broker ample time to continue negotiating with underwriters to ensure Metro obtains the most competitive pricing.

## **DISCUSSION**

Property insurance protects against losses to structures, fleets, and improvements, valued at approximately \$19.6 billion, up from last year's \$18.8 billion. The increase in total insured value is primarily due to general replacement cost growth and the revaluation of both heavy and light rail vehicles. In addition, the Regional Connector Project has been fully incorporated into the overall statement of values. The inclusion ensured that no gaps in protection occurred during the transition into revenue operations. Property insurance is also required by many contracts and agreements, such as lease/leaseback agreements 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 \$550 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 \$1,000,000 with no earthquake coverage and a flood deductible of 5% per location, subject to a \$1,000,000 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 \$550 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 \$1,000,000 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 \$550 million in coverage limits and a not to exceed deductible of \$1 million. Attachment A shows the renewal program structure outline within the requested parameters. 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. We rejected this coverage in the past 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.

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

In January, February, and March 2024, 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, newer construction, and State of Good Repair programs. USI presented the submission to incumbent and new insurers to create competition in the insurance marketplace and for additional capacity. Incumbent carriers were maintained but at some reduced participation, requiring additional carriers to be added to the program because of our large values. Due to the continuing hard market, Metro's estimated renewal rate and premium are expected to increase, but not as significantly as in past years. 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. Programs historically written by a single insurer moved to shared and layered program structures in which multiple participants provide capacity. London and Bermuda insurers took on larger positions in programs in which admitted markets vacated or reduced capacity.

Carriers are looking to return their portfolios to profit, which has led to continuing universal rate increases even for insureds that are claims-free. Insurers are instituting more restrictive terms along with premium increases and higher deductibles. Carriers are rated on the potential for loss (regardless of good loss history), and with Metro's increased valuations on buildings, facilities, buses, and rail cars, insurance carriers are rated on the potential for total loss estimates. Although most of Metro's property is not in official flood zones, heavy rain over the past few years has shown that Los Angeles is prone to more flood and water damage than officially mapped, which is a growing concern to underwriters.

Metro has historically enjoyed some of the lowest rates among transit systems and remains an attractive client within this space. However, due to the hardening of the insurance market, premium

pricing has increased exponentially over the past few years, and carriers continue to reduce their appetite for transit risks. This year's renewal is again challenging, but Metro's favorable insurability, loss record, 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 riders or employees.

### **FINANCIAL IMPACT**

The funding for two months of \$1.7 million for this action is included in the FY24 Budget in cost center 0531, Non-Departmental Ops Risk Management, under projects 100001 - General Overhead, 300022 - Rail Operations - A Line, 300033 - Rail Operations - C Line, 300044 - Rail Operations - B Line, 300066 - E Line, 300077 - Rail Operations - K Line, 301012 - Bus Operations - G Line, 306001 - Operations Transportation, 306002 - Operations Maintenance, and 610061 - Owned Property.

The remaining ten months of \$8.5 million is included in the FY25 Budget Request under the same cost center and projects as listed above.

Additional funds required to cover premium costs beyond the budgeted amounts will be addressed by fund reallocations during the year.

#### **Impact to Budget**

The source of funding for this action will come from federal, state, and local funding sources that are eligible for bus and rail operations.

### **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, BIPOC (Black, Indigenous, and People of Color), people with disabilities, people with limited English proficiency, 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 and that service may resume. The 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.

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**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 premiums does not justify the benefit of the coverage.

**NEXT STEPS**

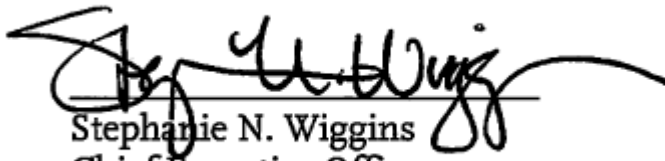
Upon Board approval of this action, staff will advise USI to proceed with the placement of the property insurance program outlined herein, effective May 10, 2024.

**ATTACHMENTS**

Attachment A - Recommended Renewal Program Pricing  
Attachment B - Alternatives Considered

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