



Board Report

File #: 2019-0027, File Type: Program

Agenda Number: 7.

FINANCE, BUDGET AND AUDIT COMMITTEE APRIL 17, 2019

SUBJECT: PROPERTY INSURANCE PROGRAM

ACTION: PURCHASE ALL RISK PROPERTY AND BOILER AND MACHINERY INSURANCE

RECOMMENDATION

AUTHORIZE the Chief Executive Officer to negotiate and purchase All Risk Property and Boiler and Machinery insurance policies for all property at the current policy limits at a not to exceed price of \$3.1 million for the 12-month period May 10, 2019 through May 10, 2020.

ISSUE

The All Risk Property and Boiler and Machinery insurance policies expire on May 10, 2019.

DISCUSSION

Property insurance protects against losses to our structures, fleets and improvements, which are valued at approximately \$12.3 billion up from last year's \$12.1 billion. The increase in total insured value is primarily due to general replacement cost growth along with revaluation of both heavy and light rail vehicles and the addition of the Southwest Yard to Metro's property program. Property insurance is required by many contracts and agreements, such as our lease/leaseback deals involving a number of our operating assets.

Our insurance broker, USI Insurance Services ("USI") marketed the property program to qualified insurance carriers to obtain property insurance pricing with coverage limits of \$400 million. Quotations for our property insurance program were received from carriers with A.M. Best ratings indicative of acceptable financial soundness and ability to pay claims. Final pricing is pending, so the quotes serve as a not to exceed cost excluding contingency for unanticipated adjustments 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 \$400 million per occurrence for losses except for flood related damages that are covered up to \$150 million. 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 \$4.65 million for \$50 million in limits with a 5% deductible. LACMTA 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 government agencies including most Los Angeles County and City locations, Department of Water and Power and Metropolitan Water District.

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 nearly \$850,000. 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. For the present, we will continue to reject terrorism coverage.

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 February and March, USI contacted multiple domestic and foreign 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 nineteen years with one fixed property insurable event and under \$1.3 million insurable losses of rolling stock and non-revenue vehicles.

The LACMTA property program continues to be well received by insurers due to our favorable loss history and the growth of the account from \$6.7 billion in values in 2007 to \$12.3 billion for this renewal. As such, USI presented the submission to incumbent and competing insurers to create competition in the insurance program. The marketing effort resulted in maintaining most of our incumbent carriers for the recommended program. Our rate per million dollars of insurable value is \$252 for the recommended program which represents a 26.5% 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 soft market for all lines of insurance coverage Metro has enjoyed for many years has hardened. The catastrophic events of 2018, including the California wildfires, will place renewed pressure on property specific pricing that produces an adequate risk adjusted rate of return to the insurance

carriers for property coverage. The near-term rate impacts will result in higher premiums because of current losses (size and frequency) being paid by property markets after many quarters of soft and declining pricing.

Jeff McNatt, executive vice president for AmWINS, one of the largest global specialty insurance distributors, explains, "The primary carriers have suffered the most over the last two years, and this has caused many primary markets to tighten their underwriting guidelines, push for rate (increases), or exit classes of business." (AmWINS State of the Market, Q1 2019 report) The report further states, "Carriers were hit globally by severe storms in 2018. Worldwide catastrophe (CAT) loss estimates for 2018 are expected to be close to \$80 billion, above the 20-year average of \$57 billion. Domestically, the fourth quarter saw both Hurricane Michael and wildfires in California, which combined are expected to generate losses between \$18-28 billion - well above the typical Q4".

Underwriting trends will include market hardening, carrier retrenching, and an emphasis on profit as discussed in a recent on-line article from AmWINS. "As we head deeper into the first quarter of 2019, one thing is clear: changes are coming to the insurance marketplace that buyers and brokers alike will experience as the year progresses. Carriers are feeling pain, not just in commercial auto and problematic property sectors, but across many other areas of property and casualty as well." ("The 2019 Market: Changes are Coming", AmWINS, March 6, 2019)

This year's renewal reflects our continuing favorable insurability and ability to take full advantage of USI marketing efforts in a very different and demanding market environment from previous years.

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 \$517,000 for this action is included in the FY19 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). The remaining ten months of premiums will be included in the FY20 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). In FY19, an estimated \$2.5 million will be expensed for property insurance.

Impact to Budget

There is no impact on the FY19 budget. 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 negligible change to operating costs from the prior fiscal year.

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 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, 2019.

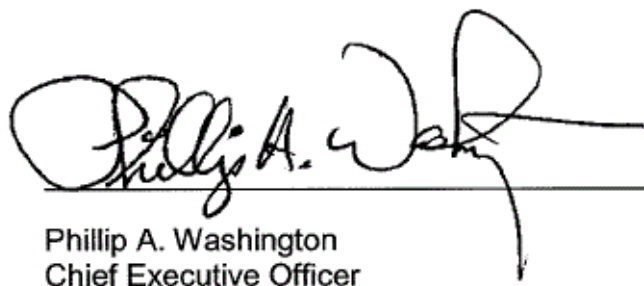
ATTACHMENTS

Attachment A - Recommended Pricing and Carriers

Attachment B - Alternatives Considered

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