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

File #: 2020-0895, **File Type:** Program **Agenda Number:** 8.

FINANCE, BUDGET AND AUDIT COMMITTEE
APRIL 14, 2021

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 increased policy limits at a not to exceed price of $4.75 million for the 12-month period May 10, 2021 through May 10, 2022.

ISSUE

The All Risk Property and Boiler and Machinery insurance policies expire on May 10, 2021.

DISCUSSION

Property insurance protects against losses to our structures, fleets, and improvements, which are valued at approximately $13.6 billion, up from last year's $13.3 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. Last year we included the value of the Crenshaw/LAX Line in our total insured values. However, through an agreement with our insurance carriers, we did not pay for the premium incurred by adding the Line since the Line was not accepted by Metro during the insurance term. We will pay premium attributed to the addition of the Crenshaw/LAX Line this policy period. 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 $425 million. This limit is $25 million more than the last program to reflect an increase in insured values for Metro's assets over the years. 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 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 with the exception of the increased limits as noted. 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 $7 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 $320,000 for $425 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 2021, 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 $13.6 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 many of our incumbent carriers for the recommended program. Our rate per million dollars of insurable value is $349 for the recommended program which represents a 27.7% 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 disruption. 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 five years continue to show higher than expected loss development. The 2020 most active hurricane season on record losses were historic in nature followed by the 2021 Texas deep freeze losses. The spring brought hailstorms and tornados to the US. Hurricane Laura caused estimated insurable losses of $8 billion to $12 billion. Insurable losses from the summer riots in the US were around $775 million, and the insurable losses from the Beirut port explosion are estimated to be about $3 billion. Losses from the numerous wildfires that hit the nation's West Coast in late summer are sure to be high as well. Carriers are looking to return their portfolios to profit and this has led to continuing universal rate increases (even for insureds that are claims-free).

"There are times when carriers view past renewal increases as adequate and are now offering a more moderate rate increase," says Harry Tucker, Amwins National Property Practice Leader. "However, accounts with difficult exposure characteristics and/or poor loss experience are still seeing stout price increases and more restrictive coverage." "This is not a traditional hard market. In this market, supply and demand are not the principal drivers of pricing," Tucker says. "There is ample capacity in the market, its availability is dependent on risk perception and rate." 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. Overall, carriers are looking to get back to profitability and continue to re-engineer their books, given the pre-2018 prolonged soft market pricing, loss experience and low interest rate investment environment according to the Amwins 2021 1Q State-of-the-Market report.

Along with premium increases, carriers are looking for higher deductibles and more restrictive terms. Carriers are rating on the potential for loss (regardless of good loss history) and with increased valuations on buses and rail cars, 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 marketing efforts in a very different and demanding market environment from previous years while adding our Crenshaw/LAX Line to Metro's portfolio of property.

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 $792,000 for this action is included in the FY21 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 FY21, an estimated $3.8 million will be expensed for property insurance.

The remaining ten months of premiums will be partially included in the FY22 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). Additional funds required to cover premium costs beyond FY22 budgeted amounts will be addressed by fund reallocations during the year.

Impact to Budget

Additional funds required to cover premium costs beyond FY21 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.

IMPLEMENTATION OF STRATEGIC PLAN GOALS

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 but adding an additional $25 million in limits 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, 2021.

ATTACHMENTS

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

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