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

File #: 2018-0014, **File Type:** Program **Agenda Number:** 16.

FINANCE, BUDGET AND AUDIT COMMITTEE
APRIL 11, 2018

SUBJECT: PROPERTY INSURANCE PROGRAM

ACTION: PURCHASE ALL RISK PROPERTY AND BOILER AND MACHINERY INSURANCE

RECOMMENDATION

AUTHORIZE the Chief Executive Officer to negotiate and award All Risk Property and Boiler and Machinery insurance policies for all property at the current policy limits at a not to exceed price of $2.5 million for the 12-month period May 10, 2018 through May 10, 2019.

ISSUE

The All Risk Property and Boiler and Machinery insurance policies expire on May 10, 2018.

DISCUSSION

Property insurance protects against losses to our structures and improvements, which are valued at approximately $12.1 billion up from last year's $11.9 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. Property insurance is required by many contracts and agreements, such as our lease/leaseback deals involving a number of our operating assets.

Natural disasters last year will take a toll on property insurance carriers. Catastrophic events included Hurricane Harvey (estimated $40 billion in insured losses), Hurricane Irma (estimated $35 billion in insured losses), Hurricane Maria (estimated $30 billion in insured losses), California wildfires (estimated $12 billion in insured losses) and earthquakes in Mexico (estimated $1.5 billion in insured losses). Commercial property prices, which had been decreasing for much of the recent past, now indicate increases in the single digits according to a March 2018 Willis Towers Watson commercial lines insurance pricing survey. Pierre Laurin, Willis Towers Watson's Americas property/casualty sales and practice leader for insurance consulting and technology, said, "Last year's weather disasters were some of the most financially disruptive in history, and the survey results indicate we're likely now seeing the initial response to the catastrophes on the pricing side of the property market."

Our insurance broker, USI Insurance Services ("USI") acquired Metro's prior broker Wells Fargo Insurance Services in December 2017. 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 soft market for all lines of insurance coverage Metro has enjoyed for the past 25 quarters will be temporarily placed on hold according to USI. Any long term upward pressure on rates will be tempered and mitigated by available abundant capacity from alternative capital providers. However, 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. The catastrophic events of 2017 and early 2018 will place renewed pressure on returning to property specific pricing that produces an adequate risk adjusted return to the carriers for property coverage.

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. 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 is a premium history. Attachment B 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 $4.5 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 $823,000. The Terrorism Risk Insurance Act (TRIA) which provides government support by providing mechanisms for spreading losses across policyholders was reauthorized by Congress in January 2015 after the program expired. 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.

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 eighteen years with one fixed property insurable event and under $1.2 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, the growth of the account from $6.7 billion in values in 2007 to $12.1 billion for this renewal without the requirement of providing earthquake coverage. As such, USI presented the submission to incumbent and competing insurers to create competition in the insurance program. The marketing effort resulted in maintaining all but one of our incumbent carriers for the recommended program. Our collaborative marketing effort through USI resulted in a not to exceed 2.77% premium increase for the recommended program. Our rate per million dollars of insurable value continues to reflect historic lows ($207 for the recommended program versus $246 for the 2012 - 2013 program). However, we did experience a nominal rate increase per million dollars of insured value over the prior year.

The Willis Towers Watson report concludes, “Underwriters will be pushing for rate increases as they reconcile what is expected to be a significant earnings hit for many, and a potentially material capital hit for some. For underwriters needing to dip into capital to fund their losses, the pressure to raise rates to replenish that capital could be unyielding. For buyers, this may mean the long soft market for commercial property insurance could be over, at least temporarily.”

This year’s renewal reflects our continuing favorable insurability and ability to take full advantage of market trends irrespective of our 1.6% increase in total insured value 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 $416,667 for this action is included in the FY18 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 FY19 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 FY18, an estimated $2.4 million will be expensed for property insurance.

Impact to Budget

There is no impact on the FY18 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 C. Based upon our favorable renewal and loss histories, 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, 2018.

ATTACHMENTS

Attachment A - Premium History
Attachment B - Recommended Pricing and Carriers
Attachment C - Alternatives Considered

Prepared by: Tim Rosevear, Manager, Risk Financing, (213) 922-6354

Reviewed by: Greg Kildare, Chief, Risk, Safety and Asset Management Officer, (213) 922-4971

Phillip A. Washington
Chief Executive Officer