



Agenda Item No. 3

To: Finance-Auditing Committee/Committee of the Whole
Meeting of March 9, 2006

From: Joseph M. Wire, Auditor-Controller
Celia G. Kupersmith, General Manager
William L. Stafford, Director of Risk Management/Safety

Subject: **APPROVE RENEWAL OF THE PROPERTY INSURANCE PROGRAM**

Recommendation

This item is informational.

Summary

The Bridge Property Insurance renewal occurs each March and includes insurance policies covering the Bridge, Buildings and Facilities, and Boiler and Machinery. Final information for all three will come to this committee at its March 23rd meeting followed by Board action on the 24th of March. During today's meeting, staff is providing information solely on the Bridge Insurance policy for discussion purposes.

Bridge Insurance

The District received a quote on the Bridge Insurance policy that increases the cost by 21.3%, which raises the question of whether or not the risk transfer achieved by the policy is worth the cost. This report examines that question and provides alternative options to full renewal. First, the report has information on the marketing effort to obtain the quote, the renewal quote itself and a renewal quote that cuts the coverage limits in half. Then, the report presents information on the non-renewal option.

Marketing: The District's insurance broker, Marsh Risk & Insurance Services, has provided a detailed report on the insurance market and the marketing of the Bridge Insurance policy which is attached.

The major hurricanes during the last year have put pressure on insurance carriers to implement dramatic increases on property insurance rates, especially those with catastrophic exposure.

Much of the increase can be attributed to increased reinsurance costs. It has been reported by Marsh that the Bridge Physical Damage/Loss of Use insurance coverage premium increase (21.3%) is solely due to reinsurance costs.

Marsh marketed the Bridge program to markets in the U.S., United Kingdom, Europe and Bermuda to gauge interest in the program. After reviewing all responses, the renewal quote provided by the incumbent ACE is the only quote that Marsh received.

ACE, the incumbent and the only insurance carrier agreeing to quote this coverage, was informed that the District would consider self-insurance if more favorable terms and/or conditions were not available.

Renewal Quote (Option 1): The renewal quote is for the same coverage that the District has today. The total proposed cost of the Bridge Physical Damage/Loss of Use insurance programs for a 12-month period between April 8, 2006, and April 7, 2007, is \$1,289,688, a 21.3% increase from the previous year. This is for coverage with a self-insured deductible of \$15 million with a \$25 million limit on property damage and a \$25 million limit on loss of use with a 30 day waiting period. We are self-insured in excess of \$50 million for both coverages.

Alternative Quote (Option 2): Based on the initial premium quote of \$1,289,688, the District asked Marsh for alternative proposals with the same self-insured deductible. The alternative program quoted provides a limit of \$12.5 million property damage and \$12.5 million use and occupancy. This is exactly one-half of limits on the expiring program. The deductibles remain the same at \$15 million for property damage and 30 days for use and occupancy. The premium/taxes for the alternative quote are \$794,448. Lowering the limit by half reduces the premium by 38.4% from the \$1,250,000 premium quoted for the expiring program.

Both quotes do not include terrorist coverage or earthquake coverage for the property damage portion of the coverage.

Bridge Property Non- Renewal Option (Options 3 & 4)

Marsh has recommended that the District review its need to maintain this coverage. Marsh in their attached report recommends that “the District needs to determine the value of this program after comparing the extent of the protection provided against the premium cost, deductible exposure and the rising replacement value of the Bridge and increased revenue stream. Is it in the District’s best interest to self-insure this exposure or incur the cost to transfer the risk?”

The key point with regard to “transfer of risk” is that currently the District only transfers part of the risk. For property, the District is currently self-insured up to \$15 million then transfers the next \$25 million in losses for a premium up to \$40 million. Excess of \$40 million for these loss exposures the District is self-insured. For use and occupancy, the District is self-insured for 30 days then transfers \$25 million in risk (three and half months of toll revenue) for a premium. Only this portion of the insurance includes earthquake coverage. Again, the District is self-insured in excess of \$50 million for both coverages when combined.

Prior to the recession of 2000/2001 and “9/11” the District had very favorable terms for this catastrophic coverage with insured limits as high as \$100 million on the property damage and a significantly larger coverage area on the use and occupancy coverage (Doyle Drive to the Richardson Bay Bridge) all with annual premiums of less than half of the current price.

The increasing premium and the amount of coverage provided have significantly reduced the value and potential monetary benefit of this coverage.

Other important factors that play into the decision to renew are:

- Progress of the seismic retrofit of the bridge. In the past one of the main arguments for purchasing this insurance was to provide the District with funding to function after a catastrophic event. With the completion of Phases I & II of the seismic retrofit of the bridge, the District has greatly reduced its exposure to catastrophic seismic events.
- Increase in the District’s reserves. The District has built up its reserves to fund future capital projects and to fund long-term liabilities. The availability of these funds would allow the District to function after a catastrophic event although the District would later have to repay the funds or alter the current capital plan.
- Alternative uses of the yearly premiums. The yearly premiums, \$1.3 million, could be put to other purposes including a Bridge Property Reserve that would be available to be used during a future event. These types of funds are used by other public and private organizations to manage their risks. The basic framework of such a fund is covered below. Such a fund would have the added benefit of strengthening the overall financial health of the District.

Finally, if the District decided to not renew the Bridge insurance this year it would still be advisable to seek quotes for the policy in future years to determine if market conditions have changed enough to make the purchase of a policy the best option.

Contingency Fund

The long term risk of self-insurance can be substantially mitigated by building a contingency fund. In the short-term, the District would have to mitigate the risk by using reserves.

For example, several years ago CalTrans decided the cost and potential benefits of their property damage and loss of use policy was not cost effective and decided to accrue funds annually in a separate fund until they reached their coverage limits.

Under the conservative assumptions listed below, it would take 13.5 years to develop a fund for the use and occupancy portion of the limits and a total of 23 years for both the use and occupancy and property portions of the coverage limits.

Assumptions:

- Coverage limits would not change, \$50 million combined damage/loss of use;
- Premiums would not change \$1.3 million annual (although this would most likely increase); and,
- The investment income on the fund would average 5% annually.

Fiscal Impact

There is no fiscal impact associated with this informational report.

Attachments:

Bridge Property Damage/Loss of Use Options
MARSH: Bridge & District Properties Renewal

BRIDGE PROPERTY DAMAGE/LOSS OF USE OPTIONS

BRIDGE PROPERTY PROGRAM OPTIONS	TYPE OF PROGRAM	DEDUCTIBLE	PROPERTY DAMAGE COVERAGE	LOSS OF USE COVERAGE	COST TO DISTRICT 2006
1	Self-Insured Risk Transfer	\$15 Million	\$25 Million	\$25 Million 30 Day Waiting Period	\$1,289,688
			Combined \$50 Million		
2	Self – Insured Risk Transfer	\$15 Million	\$12.5 Million	\$12.5 Million 30 Day Waiting Period	\$794,448
			Combined \$25 Million		
3	Self-Insured Funded	N/A	N/A	N/A	\$1.3 Million Funded
4	Self Insured Non-Funded	N/A	N/A	N/A	No Cost