MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

BOARD ACTION

- **Board of Directors**
  Audit, Budget and Finance Committee

June 12, 2001 Board Meeting

8-6

Subject

Approve Casualty and Property Insurance Program and amend the insurance broker contract

Description

Casualty and Property Insurance Program:

The existing Casualty and Property Insurance Program consists of the following lines of insurance expiring June 30, 2001:

a. Aircraft Liability policy: $25 million

b. Fidelity and Crime Bond policy: $5 million

c. Excess Liability occurrence policy: $75 million in excess of a $25 million self-insured retention (SIR)

d. Excess Workers' Compensation policy: maximum State labor code benefits in excess of a $400,000 SIR

e. Special Risk coverage: $5 million

f. Travel Accident: $100,000 to $250,000 limits and includes coverage for vanpool drivers.

Current insurance market conditions indicate that for fiscal year 2001-02, Metropolitan's Casualty and Property Insurance Program will experience premium increases of 15-83 percent by line of insurance coverage. This year's premium changes, per line of insurance coverage, vary from zero percent for the Excess Workers' Compensation premium to an 83 percent increase for the Aircraft Liability premium **(Attachment 1)**. The Workers' Compensation premium remained stable due to the recommended increase in SIR from $400,000 to $500,000 **(Attachment 2).** Other premium increases resulted from escalating insurance industry losses, diminishing investment yields and the industry's limited business capacity for risk.

The largest cost component of the Casualty and Property Insurance Program is the Excess Liability insurance coverage. During the past four months, Driver Insurance Services (Driver), Metropolitan's insurance broker, solicited proposals from a variety of insurance providers. Driver contacted nine insurance companies but received only two complete proposals.

The two complete Excess Liability insurance proposals were:

1. American International Group (AIG) partnering with X.L.Europe offering a combination of both occurrence and claims-made liability policies.
2. Associated Electric & Gas Insurance Services, Ltd. (AEGIS) partnering with Energy Insurance Mutual (EIM), offering a claims-made liability policy.

An occurrence policy covers claims arising out of incidents that occur during the policy period regardless of whether the policy is still in effect at the time the claim is made. A claims-made policy covers claims arising out of incidents that occur during the policy period, and can be filed only when the policy is in force. **Attachment 3** provides a list of the advantages and disadvantages of an occurrence policy versus a claims-made policy.

AIG's and X.L. Europe's proposal offers a combined premium of $544,700, which is 54 percent higher than fiscal year 2000-01. AIG offers $20 million of liability (occurrence policy) and X.L. Europe offers $55 million of excess (claims-made policy) without Employers' Practices Liability (EPL), for a total combined excess coverage of $75 million. For example, if a large liability claim is discovered after the end of the policy period and it exceeds $45 million; then Metropolitan's SIR would cover the first $25 million, the AIG occurrence policy would cover the next $20 million, and the X.L. Europe claims-made policy would not provide additional coverage. However, if the policy period was still current or in force when the large claim is filed then X.L. Europe would provide coverage. Changing from an occurrence policy to a claims-made policy does not pose additional undue risk for Metropolitan as long as all the layers of coverage have the same claims reporting features. The combination of both occurrences for the primary layer of liability and a claims-made policy for the excess creates a possible gap in coverage after the end of the policy period.

AEGIS, along with EIM, offered the entire $75 million of liability (claims-made policy) in excess of Metropolitan's $25 million SIR for a combined premium of $412,000 or 16 percent higher premium than fiscal year 2000-01. This is still a reasonable premium compared to 1995-96 when Metropolitan experienced premium costs of $598,000 for this same coverage during a similarly difficult market cycle **(Attachment 4)**.

The AEGIS claims-made policy is designed to provide coverage for the entire $75 million in excess of Metropolitan's $25 million SIR. If Metropolitan does not renew with AEGIS, a 36-month claims reporting provision is included at no additional cost. If AEGIS cancels or does not renew the policy with Metropolitan, then the claims-made policy reverts to an occurrence policy. In addition, AEGIS issues continuity credits (reductions in premium costs) to their renewing clients based upon claims experience and AEGIS' profits.

The $412,000 premium includes Liberty Mutual using their California admitted policy as part of the premium costs. This enables Metropolitan to comply with the State of California Insurance Code requirement to purchase insurance from those companies admitted to conduct business in California. AEGIS has been an approved surplus insurance company in the State of California since 1995.

Risk Management surveyed the City of Los Angeles Department of Water and Power and Coachella Valley Water District, AEGIS clients for over 18 years and 5 years, respectively. Both agencies confirmed receiving reductions in premium costs, excellent services and are continuing to renew with AEGIS. Based upon the liability limits and complete coverages offered, excellent references and relatively reasonable premium cost of $412,000, the AEGIS program is the best selection.

Other lines of insurance renewed include Aircraft liability, Crime Bond, Specialty Coverage and Travel Accident for three-year periods; and Excess Workers' Compensation (WC) for a total insurance premium of $120,500. These costs include the WC premium based upon increasing the WC SIR from $400,000 to $500,000 per occurrence. There have been two WC claims settled over $150,000 in the past six years. The increased SIR lowered the WC premium from $38,800 to $30,000.

The total insurance cost including the Excess Liability for fiscal year 2001-02 is $532,500.

Insurance Broker Contract:

The contract for Metropolitan's insurance broker, Driver, will be amended to add a net $333,500 to pay for the recommended Casualty and Property Insurance Program and to extend the termination date of the contract period from July 1, 2001 to September 30, 2001. The Driver contract contains Board-approved funds to pay the $120,500 insurance premiums and $18,000 broker fees for the extension. The extension provides time to complete all the transactions and receive the insurance policies without disruption to Metropolitan's insurance program. A request for proposal for an insurance broker is in progress; and a new contract for insurance brokerage services will be executed during early fiscal year 2001-02.

Policy

Metropolitan Water District Administrative Code Section 6413: Insurance Program requires the General Manager to review any changes to the insurance program. Administrative Code Section 6266 (e): Insurance Pertaining to Employees, Blanket Employee Dishonesty Coverage, requires the purchase of a blanket dishonesty policy. Administrative Code Section 9101: Risk Retention and Procurements of Insurance, requires the procurement of insurance for losses in excess of reserves ($25 million) as specified in Administrative Code Section 5202.
Bond covenants require Metropolitan to consider insurance for financing catastrophic losses when reasonable.

CEQA

The proposed action is not defined as a project under the California Environmental Quality Act (CEQA) because the proposed action involves continuing administrative activities (Section 15378(b)(2) of the State CEQA Guidelines). In addition, where it can be seen with certainty that there is no possibility that the activity in question may have a significant effect on the environment, the activity is not subject to CEQA (Section 15061(b)(3) of the State CEQA Guidelines).

The CEQA determination for both options is: Determine that the proposed action is not subject to CEQA per Sections 15061(b)(3) and 15378(b)(2) of the State CEQA Guidelines.

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and:

a. Approve the AEGIS Excess Liability (claims-made policy) insurance premium payment of $412,000.
b. Amend the Driver contracts adding $333,500 for payment of all insurance premiums.
c. Extend the Driver contract period from July 1, 2001 to September 30, 2001.

Fiscal Impact: The total cost of $550,500 for the casualty and property insurance program will be less than the Risk Management fiscal year 2001-02 budget estimate of $591,000 for these expenditures.

Option #2

Adopt the CEQA determination and:

a. Approve AIG Excess Liability Program (combination of occurrence and claims-made policies) with reduced EPL limits of $20 million) for a premium payment of $544,700.
b. Amend the Driver contracts adding $466,200 for the payment of all insurance premiums.
c. Extend the Driver contract period from July 1, 2001 to September 30, 2001.

Fiscal Impact: The $683,200 cost for this option will require an additional $92,200 to the Risk Management fiscal year 2001-02 budget for these expenditures.

Staff Recommendation

Option #1

Brian G. Thomas 6/4/2001
Brian G. Thomas — *Date*
Chief Financial Officer

Ronald R. Gastelum 6/4/2001
Chief Executive Officer — *Date*

Attachment 1 – Casualty and Property Insurance Program, Fiscal Year 2001-02 Renewal Summary

Attachment 2 – Historical Premiums - Workers' Compensation

Attachment 3 – Occurrence Policy versus Claims-Made Policy

Attachment 4 – Historical Premiums - Excess Liability

BLA #1120

The Metropolitan Water District
2001-02 Renewal Summary

	Coverage	Expiring (Modified) 2000-01	Option 1 2001-02	Option 2 2001-02
1	**Excess Liability - Primary Layer**			
a	**Carrier**	**AIG**	**AEGIS**	**AIG**
b	Premium, Taxes & Fees	$352,000	$280,000	$179,700
c	Limit	$75MM	$35MM	$20MM
d	California Status	Admitted	Admitted thru Liberty Mutual Fronting Arrangement	Admitted
e	Coverage Format	Occurrence	Claims Made	Occurrence
f	**Reinsurers**	**Not Available**	**Liberty Mutual Ins. Co.** PMA Re. Please see attached for entire list of major reinsurers	**Not Available**
2	**Excess Liability - Excess Layer**			
a	**Carrier**	**AIG**	**EIM**	**X.L. Europe**
b	Premium, Taxes & Fees	Included	$132,000	$365,000
c	Limit	Included	$40MM	$55MM
d	California Status	Admitted	Non-Admitted	Non-Admitted
e	Coverage Format	Occurrence	Claims Made	Claims Made
f	**Reinsurers**	**Not Available**	**Not Available**	**Not Available**
	Sub - Total	$352,000	$412,000	$544,700
3	**Excess Workers' Compensation**			
a	**Carrier**	**AIG**	**ERC**	**ERC***
b	Premium, Taxes & Fees	$30,083	$30,000	$30,000
c	Attachment Point	$400,000	$500,000	$500,000
d	Limit	Statutory/$2MM EPL	Statutory/$2MM EPL	Statutory/$2MM EPL
4	**Aircraft Liability**			
a	**Carrier**	**USAIG**	**Westchester Fire Insurance Co.**	**Westchester Fire Insurance Co.**
b	Premium, Taxes & Fees	$16,930	$32,000	$32,000
c	Limit	$25MM	$25MM	$25MM
5	**Travel Accident**	(Incepted in 1998)		
a	**Carrier**	**AIG Life**	**Life Ins. Co. of North America**	**Life Ins. Co. of North America****
b	Premium, Taxes & Fees	$37,830 ($37,830/3 is for year pre-paid)	$36,500 ($36,500/3 is for year pre-paid)	$36,500 ($36,500/3 is for year pre-paid)
c	Limit	Class I & II: $250,000 Class III & IV: $100,000 Air Aggregate: $5MM	Class I & II: $250,000 Class III & IV: $100,000 Air Aggregate: $5MM	Class I & II: $250,000 Class III & IV: $100,000 Air Aggregate: $5MM
6	**Special Risk**	(Incepted in 1998)		
a	**Carrier**	**ACE**	**AIG**	**AIG**
b	Premium, Taxes & Fees	$8,750 $8,750/3-year pre-paid	$8,000 $8,000/3-year pre-paid	$8,000 $8,000/3-year pre-paid
c	Limit	$5MM	$5MM	$5MM
7	**Commercial Crime**			
a	**Carrier**	**AIG**	**AIG**	**AIG**
b	Premium, Taxes & Fees	$11,818	$14,000	$14,000
c	Limit	$5MM	$5MM	$5MM
	TOTAL	**$457,411**	**$532,500**	**$665,200**

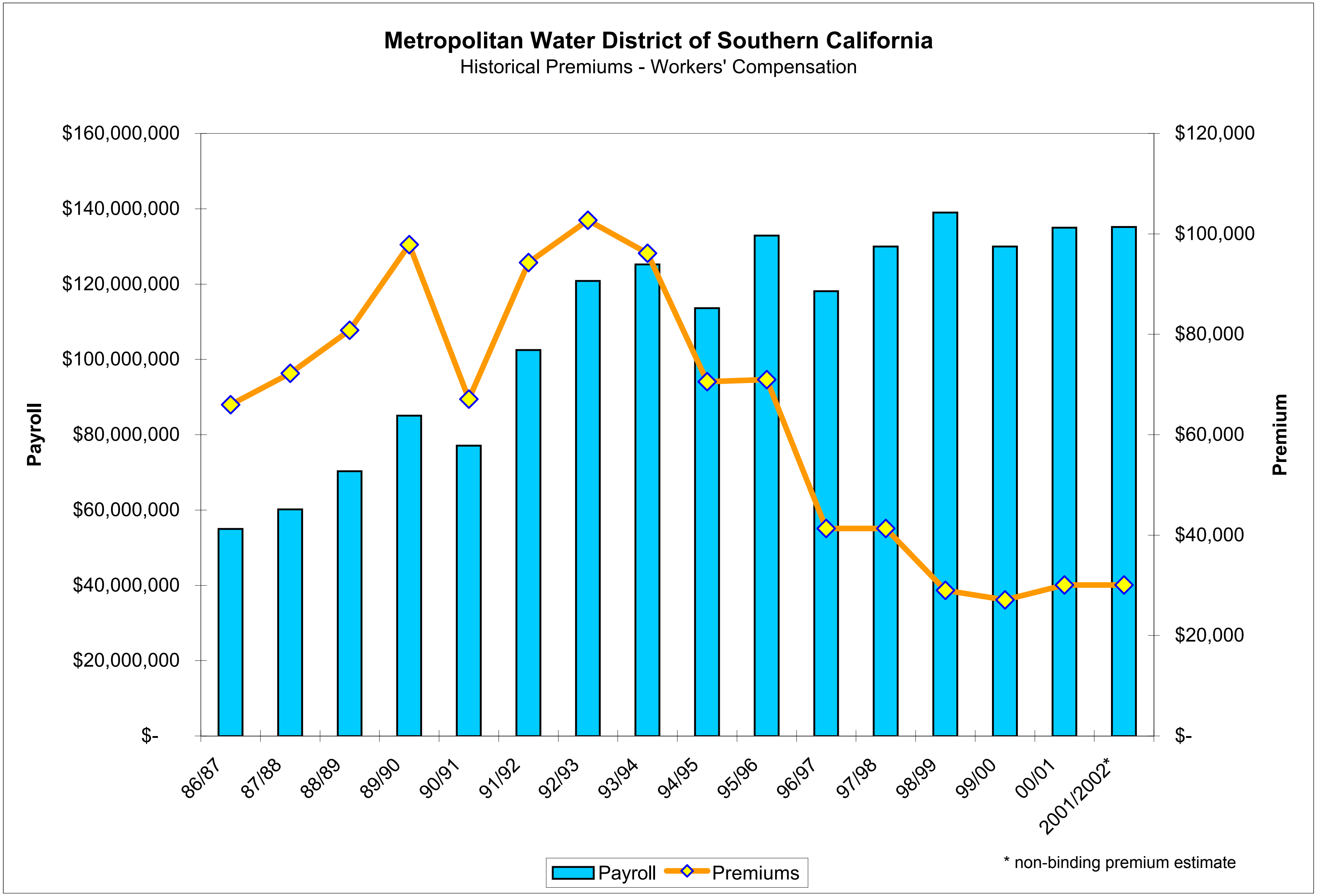
Notes:

1 Three year policy premiums shown are for entire three years of coverage. In Years 2 and 3, no premium payment is made.
2 If not otherwise indicated, all carriers proposed have an "admitted" status in the State of California.
3 The broker fee ($18,000) for the extension is not included in the total
4 X.L. Requires further underwriting prior to binding coverage
* Alternate quote from AIG for $400,000 SIR = $38,000
** Alternate quote from AIG for $42,000/3-year pre-paid

Option 1: $532,500 - 16% higher than modified program
Option 2: $665, 200 - 45% higher than modified program

Major Aegis Reinsurers

Liberty Mutual Insurance Company
PMA Re.
NEIL
NAC Re.
Zurich
Folksamerica Re.
St. Paul Re.
TIG Re.
TransAtlantic Re.


Metropolitan Water District of Southern California
Historical Premiums - Workers' Compensation
Payroll
Premium
$160,000,000
$140,000,000
$120,000,000
$100,000,000
$80,000,000
$60,000,000
$40,000,000
$20,000,000
$-
$120,000
$100,000
$80,000
$60,000
$40,000
$20,000
$-
86/87
87/88
88/89
89/90
90/91
91/92
92/93
93/94
94/95
95/96
96/97
97/98
98/99
99/00
00/01
2001/2002*
Payroll
Premiums
* non-binding premium estimate

Occurrence Policy Versus Claims-Made Policy

Source: Commercial Liability February 1995, II.C.19

Occurrence Advantages

- The “tail”(coverage beyond the policy in force) is covered forever without additional premium charges
- No added cost to change insurers

Claims-Made Advantages

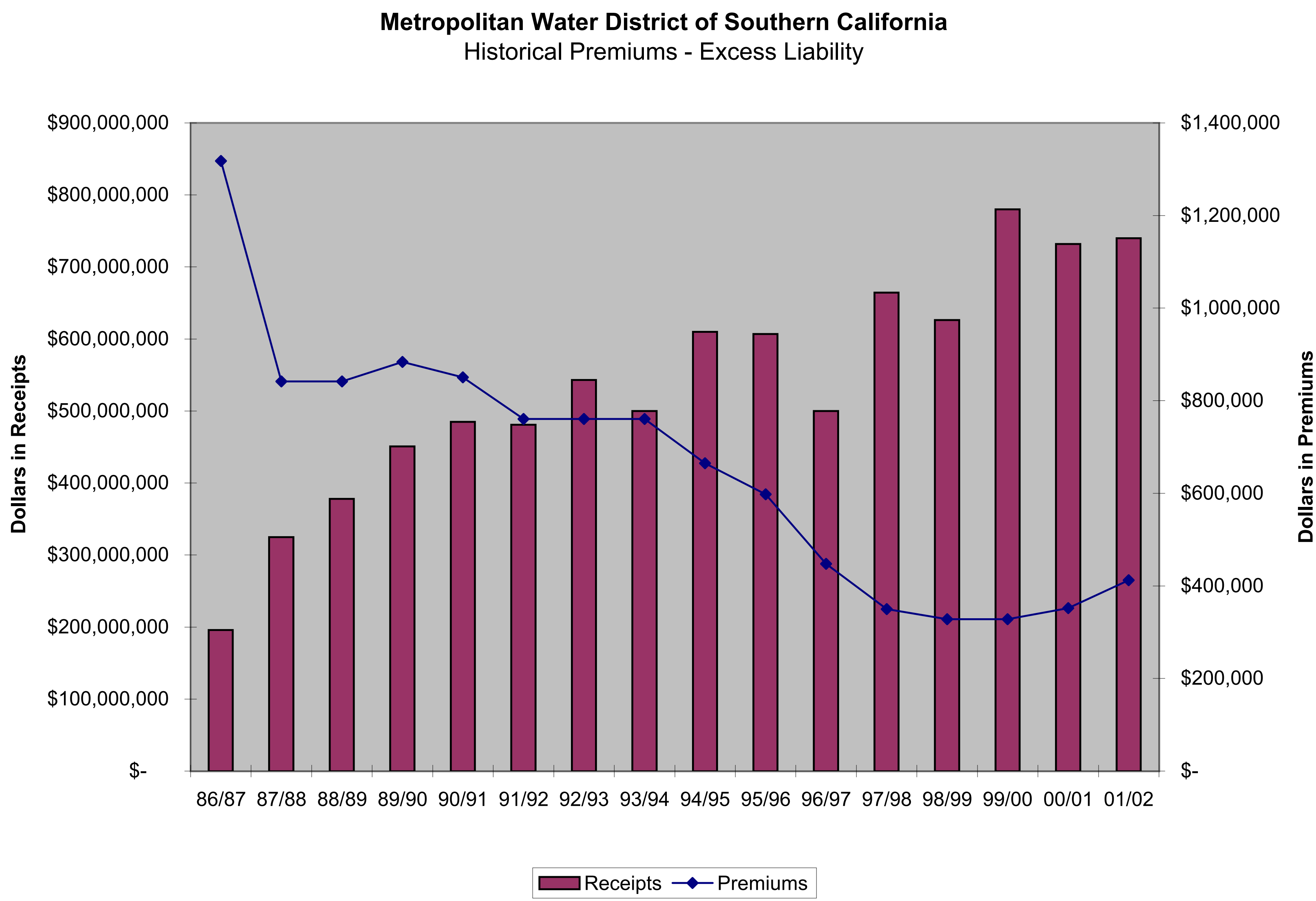
- Limits updated with inflation
- Date of claims easily ascertained
- Retroactive liability insurance may be provided
- Initially less expensive
- Insurer insolvency risk may be reduced

Occurrence Disadvantages

- Limits do not keep up with inflation
- May be difficult to ascertain the date of occurrence
- Must keep copies of all policies indefinitely

Claims-Made Disadvantages

- Tail coverage may be needed in the event of cancellation, non-renewal, etc.
- Can be expensive to change insurers
- Extended reporting period option may be required on specific accidents


Metropolitan Water District of Southern California
Historical Premiums - Excess Liability
Dollars in Receipts
Dollars in Premiums
$900,000,000
$800,000,000
$700,000,000
$600,000,000
$500,000,000
$400,000,000
$300,000,000
$200,000,000
$100,000,000
$-
$1,400,000
$1,200,000
$1,000,000
$800,000
$600,000
$400,000
$200,000
$-
86/87
87/88
88/89
89/90
90/91
91/92
92/93
93/94
94/95
95/96
96/97
97/98
98/99
99/00
00/01
01/02
Receipts
Premiums