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FINANCE AND BUDGET COMMITTEE
MARCH 18, 2009

SUBJECT: PROPERTY INSURANCE PROGRAM FOR OPERATIONS

ACTION: RECEIVE AND FILE

RECOMMENDATION

Receive and file report on the proposed property insurance program for Operations.

ISSUE

The All Risk Property insurance policy and Boiler and Machinery insurance policy for all of our property will expire on May 10, 2009. This report summarizes the current insurance marketplace for property coverage and recommends a structure for the replacement policy.

DISCUSSION

Our insurance broker, Aon Risk Services, is responsible for marketing the property program to qualified insurance carriers. Quotes are currently being received from carriers with A.M. Best ratings indicative of acceptable financial soundness and ability to pay claims. The premium indications below are based upon current market expectations. Final pricing; however, is not available until approximately 30 days prior to binding coverage.

Property insurance protects against losses to our structures and improvements, which are valued at approximately $7.6 billion. In addition, property insurance is required by many contracts and agreements, such as our lease/leaseback deals involving a number of our operating facilities.

The property insurance market for 2008 included challenges for both underwriting and investment. The 2008 loss year was the fourth worst in history, with major hurricanes, like Ike which hit south Texas, flooding and windstorms that affected large swaths of the central United States, windstorm Emma in Western Europe, California wildfires, as well as others. These losses have depleted the insurance capital base, reducing the capital available to write policies, putting upward pressure on primary insurance pricing.

Despite relatively conservative investment philosophies in the insurance industry, capital available for insurance company's and reinsurer's underwriting has declined with investment losses, (i.e., roughly 2/3 of portfolios are in high grade corporate, municipal and treasury bonds). Reinsurers in 2008 have seen capital reductions of roughly 15%, while insurers have experienced capital reductions in the range 25%. These investment declines are unprecedented in the modern insurance industry. Ramani Ayer, CEO of The Hartford, was quoted as stating that "[2008] was clearly the most challenging year in our company's 200-year history. The capital markets proved to be especially challenging during the latter half of 2008, particularly affecting our equity-based businesses and investment performance." These investment losses reduce capital, affecting the supply of insurance available to consumers and pushes insurance prices upward.

Mitigating this firming trend in pricing is the current global recession. Demand for insurance is dropping with lower corporate and personal income declines. In this economic climate, insured's are far less able to pay increasing rates. Decreasing demand for insurance, because of the global downturn, is constraining upward pricing pressure. Therefore, specific directional predictions on rates are not possible, and some insured's are seeing increases while other may receive modest decreases.

This year, as in prior years, earthquake coverage is only available with low limits at high premiums; $30 million in limits for approximately $3 million. In just over ten years, premiums would total more than the coverage afforded by the policies. As in last year's renewal, the recommended program does not include earthquake coverage. Elimination of earthquake coverage is consistent with decisions made by other large organizations such as BART, Los Angeles Department of Water and Power, Metropolitan Water District and most Los Angeles County and City locations. Elimination of this coverage will mean greater reliance on FEMA for recovery. As demonstrated by the hurricane related property losses in New Orleans and more recently in South Texas, municipal services, public utilities, and public transportation received priority FEMA funding for disaster relief.

Similarly, terrorism coverage is available for approximately $2 million. However, consistent with last year and the practice of many large public agencies, we recommend rejecting this coverage because of FEMA priority funding for transit and its relatively high cost.

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 $300 million per occurrence for losses except $100 million for flood related damages. Attachment A is a premium history. Attachment B shows the outline of the current program structure. The Recommended Program is the same policy structure as last year's renewal.

The current program of insurance is a layered structure in that several insurance carriers participate with each contributing a portion of coverage. Carriers affiliated with the American International Group of insurance companies (AIG) are currently part of the program of insurance. Continual monitoring through internal methods as well as updates provided by our insurance broker ensure that all carriers maintain the required financial ratings indicated by financial reporting agencies and as determined by A.M Best. AIG meets the ratings requirement at this time.

In February, the staff and Aon Risk Services met with multiple domestic and foreign insurance providers, including several Lloyd's of London syndicates, to present our property risks and supplemental data. During the discussions we provided an overview of the system, including its extensive security infrastructure and fire protection. We also provided information and statistics on system operations, assets, and our loss history over the past eight years (only one fixed property insurable event, the January 2001 fire at the Gateway building, whose estimated final cost is $518,663 and one loss of rolling stock currently estimated at $750,000), in order to demonstrate the high quality risk that we offer to the property insurance marketplace. This marketing effort along with demonstrable evidence of superior loss experience may serve to hold rate increases within the 0% to 5% range despite some firming of the insurance market. The potential increase in overall premium is well within acceptable levels as the total insured value has also increased approximately 5% to reflect the addition of the Metro Gold Line Eastside Extension and construction cost inflation rates. Further, the proactive approach of marketing directly has led to increased interest from underwriters which could yield additional carriers willing to participate in our program.

ALTERNATIVES CONSIDERED

	Current Program	Recommended Program	Option B	Option C
Deductibles	$250,000 All Risk/5% of structure value for Flood	$250,000 All Risk/5% of structure value for Flood	$250,000 All Risk/5% of structure value for Earthquake and Flood	$250,000 All Risk/5% of structure value for Earthquake and Flood
All Risk Limits	$300 Million	$300 Million	$300 Million	$300 Million
Earthquake Limits	None	None	$30 Million	$50 Million after first $50 million of self-insured retention
Flood Limits	$150 Million	$150 Million	$150 Million	As Earthquake Limits
Total Not to Exceed or Actual Premium	**$2,245,834**	**$2,300,000**	**$5,000,000**	**$4,500,000**

NEXT STEPS

We will return to the Board for approval in April 2009 with final pricing and insurers for the recommended property insurance program.

ATTACHMENTS

A. PREMIUM HISTORY
B. FY09 FINAL PRICING AND CARRIERS

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Chief Financial Services Officer and Treasurer

Roger Snoble
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ATTACHMENT A

PREMIUM HISTORY

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10 est.
All Risk	$5.4 Mil	$5.5 Mil	$4.8 Mil	$4.6 Mil	$3.9 Mil	$3.1 Mil	$2.1 Mil	$2.2 Mil
Boiler & Machinery	$135,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000
Total Premium	$5.5 Mil	$5.6 Mil	$4.9 Mil	$4.7 Mil	$4.0 Mil*	$3.2 Mil*	$2.2 Mil*	$2.3 Mil*
TIV = Total Ins. Val.	$5.2 Bil	$5.8 Bil	$6.0 Bil	$6.5 Bil	$6.7 Bil	$6.7 Bil	$6.9 Bil	$7.6 Bil**

* Excludes Earthquake Insurance
** Includes approximately $400 Mil for Eastside Extension improvements

ATTACHMENT B

FY09 FINAL PRICING AND CARRIERS

LOS ANGELES COUNTY METROPOLITAN TRANSPORTATION AUTHORITY
PRIMARY/EXCESS PROPERTY
POLICY TERM: MAY 10, 2008 TO MAY 10, 2009

Excess Limit		Layer(s)	Participation	Carrier	Line %	Premium	Estimated Taxes	Layer Price	Carrier Status	Company AmBest Rating
$150M	ALL RISK EXCLUDING EARTHQUAKE AND FLOOD	$150M xs $150M (Quota Share)	$ 50,000,000	Commonwealth Insurance Co.	33.33%	$ 100,000	$ 3,125	**$ 300,000**	Non Admitted	A IX
			$ 50,000,000	Continental Casualty (C.N.A.)	33.33%	$ 100,000	$ -	**$ 300,000**	Admitted	A XV
			$ 50,000,000	Axis Surplus Insurance Co.	33.33%	$ 100,000	$ 3,125	**$ 300,000**	Non Admitted	A- IX
			$ 150,000,000	**Layer Total**	**100.00%**	**$ 300,000**	**$ 6,250**			
$150M	ALL RISKS INCLUDING FLOOD EXCLUDING EARTHQUAKE	$150M Primary (Quota Share)	$ 100,000,000	**LEXINGTON**	66.67%	$ 1,266,667	$ 39,583	**$ 1,900,000**	Non Admitted	A XV
			$ 50,000,000	**LIBERTY MUTUAL**	33.33%	$ 633,333	$ -	**$ 1,900,000**	Admitted	A XV
			$ 150,000,000	**Layer Total**	**100.00%**	**$ 1,900,000**	**$ 39,583**			
					Total	**$ 2,200,000.00**	**$ 45,833**			
							$ 2,245,833			