Agenda Report

June 24, 2002

TO: CITY COUNCIL

FROM: CITY MANAGER

SUBJECT: Purchase of City Property Insurance for the period May 15, 2002 - May 15, 2003

RECOMMENDATIONS:

It is recommended that the City Council authorize the City Manager to purchase Property Insurance under a joint purchase program established by the City's Broker of Record,
Driver Alliant Insurance Services, at an annual premium not to exceed $591,283 for the term, May 15, 2002 to May 15, 2003.

BACKGROUND:

The annual renewal premium for the City's Property Insurance Program will be $591,283.00, a decrease of $50,437.10 as compared to last year's premium of $641,720.10. Because of the changing insurance market this year, there is also a reduction in coverage.

The City purchases "All Risk" replacement cost property insurance on all City properties. In past years, City also purchased "Difference in Conditions" insurance (earthquake and flood) protection at specific City locations; historically, City Council policy has limited the purchase of earthquake insurance to those properties where bond indentures require it. (Bond indentures require earthquake coverage, but only if available at reasonable rates.) The quotation for coverage equivalent to that purchased last year was over $1,500,000. Over half the premiums were to purchase the California Earthquake coverage. As the insurance market improves, staff will attempt to obtain earthquake coverage if at reasonable rates.

The standard deductible per occurrence will be $25,000. [The deductible varies - examples include: $100,000 for vehicle collision and up to $100,000 for certain electrical apparatus, which is the same as last year.]

Policy limits have dropped to $500,000,000 from $1,000,000,000. Various sub-limits have been reduced or coverage eliminated. New exclusions are: corrosion; sabotage; terrorism; EDP electronic erasure; asbestos; and mold.

Sabotage and Terrorism coverage might be available at a rate of $.0225/$100 insured value subject to a policy limit of $100,000,000 per occurrence and annual aggregate for all members of the purchasing group, with a $500,000 self insured retention applicable. Purchase of the coverage is not recommended.

The City purchases insurance under the City's Broker of Record contract with Robert F. Driver Company, Inc., (now known as Driver Alliant Insurance Services, Inc. after a merger) on property values of $747,071,279 (a book-evaluated value increase of $10,932,979 from last year). Coverage is marketed to insurance underwriters world wide as part of a joint purchase group program established by the City's broker, called the Public Entity Property Insurance Program ("PEPIP") . The program originally combined the purchasing power of more than one hundred and fifty California public agencies to provide rates below those available to individual members. The group has expanded to include 2,800 public entities in 7 states with over $70 billion in insured values. In past years, the size and geographical diversity attracted underwriters with capacity to take risk without dependence on massive amounts of reinsurance. Participating insurers must be rated at least A-:VII by Best's Key Rating Guide. This year, the size and diversity of the members of the program did not keep down premiums, nor did it increase coverage significantly; however, it is better than a stand-alone policy for the City, especially considering the huge minimum premiums being demanded on such policies.

There are 45 insurance companies or insurance facilities participating in this year's program. Last year's lead insurer, Specialty Surplus Insurance Company, a Kemper Group Company, has had its financial rating downgraded and no longer is eligible to participate in the program. ACE Global Markets Syndicate AGM #2488 (a California admitted insurer) is the fronting company; admitted insurers are members of the State Guaranty Fund, which financially back claims payments in case of insolvencies. Claims are to be processed through an independent claims adjusting company, Maxon & Young, with an adjuster working from the Broker's office in Newport Beach.

There is no sharing of risk under this program, and each PEPIP Member is protected to the same extent as if separate policies had been written.

Earthquake coverage costs have sharply increased this year. In years prior to the soft insurance market, the City purchased a limit of $250,000,000 per location per occurrence on about $700,000,000 in insured property values. The price and terms of earthquake coverage justifies historical City Council policy to forego purchase of earthquake coverage except where bonds demand such purchase. The bonds that require purchase of earthquake coverage are on: 1) Jackie Robinson Park and Center; 2) Villa Parke Community Center; 3) Fire Stations 31 and 33; 4) Holly Street Parking Structure; 5) Delacey Parking Structure; 6) Plaza Las Fuentes; and, 7) Central Library. Last year, the properties had a Real Property insured value of $136,482,356, but the City purchased only $7.5 million of coverage. The bonds allow the City to forego purchase of earthquake coverage if market prices make the cost unavailable. This year, the cost is so prohibitive that the City is dropping all earthquake coverage.

The increase in premiums is caused by world-wide rate increases for property insurance after 10 years of rate decreases followed by increases the past two years. The increase of two years ago returned the City to a net premium slightly below what City paid in the 1998-1999 policy year. Last year's increase returned the City's premium to a rate charged in about 1996, although City has to look back to about 1990, before PEPIP was founded, to see similar net premium payments by the City of Pasadena. This year's proposed increases were unprecedented; however, with the adjustments made to the City's purchases, coverage and premiums are roughly equivalent to what was purchased before 1991, with the exception of earthquake insurance.

The September 11 terrorism incident focused insurance underwriters on the possibility of massive losses in all lines of insurance arising from a single event, including a total loss of high rise buildings or other potential terrorist targets, which could affect the solvency of insurers and the reinsurance companies. As a result, underwriters are concerned with limiting exposure to catastrophic loss potential including limiting acceptance of large-risk exposures. Public utilities are among the risks being carefully underwritten, as are stadiums, landmarks, and public buildings densely occupied by a large number of people. The California Insurance Commissioner has not approved any form for admitted insurers which exclude perils (such as a fire) resulting from a terrorist attack, yet reinsurance treaties have excluded such coverage. The inability of primary admitted carriers to spread risk through reinsurance has impacted availability of coverage (and therefore price) in this year's insurance market.

FISCAL IMPACT:

Funds for this insurance premium are budgeted in the General Liability Fund and will be charged back to departments' budget accounts as part of their General Liability rates.

Respectfully submitted,

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