Office of Superintendent of Schools
Board Meeting of April 14, 2004

March 24, 2004

Financial Affairs
Edward Marquez, Chief Financial Officer

SUBJECT: RENEWAL OF BOARD'S PROPERTY INSURANCE PROGRAM

COMMITTEE: BUSINESS AND FINANCIAL SERVICES

At the Board meeting of May 14, 2003, the Board took action to confirm the final placement of its current catastrophic, all risk, replacement cost property insurance program, with coverage limits of $500 million for windstorm, terrorism, and other covered perils, with annual premiums costs of $21,469,546. This confirmation was following the Board's authorization to secure and bind coverage with annual premiums not to exceed $22 million, which was provided at the Board meeting of April 9, 2003. At the same time, the Board authorized the Superintendent to seek a letter from the State of Florida Insurance Commissioner (presently Chief Financial Officer) regarding the reasonableness of the program, pursuant to the requirements of Section 406 of the Federal Stafford Act, and continue meetings with insurers to begin negotiations for renewal terms and conditions, including the use of a multi-year policy, and re-rate provisions, for coverage beginning May 1, 2004.

The letter from the Department of Financial Services, Office of Insurance Regulation, received in December 2003, outlines the State of Florida's acknowledgement that the Board, through its broker, Arthur J. Gallagher & Co. was successful in obtaining 2 ½ times the coverage it had previously secured, with relatively little increase in annual premium costs. Additionally, Risk Management staff, and representatives from Arthur J. Gallagher & Co., have continued to meet with current and prospective insurance markets in an effort to seek commitments for the renewal of the property program, which becomes effective May 1, 2004.

STATE OF THE PROPERTY INSURANCE MARKET

The property insurance market consistently improved throughout 2003. In the absence of any catastrophic loss, including natural disasters such as hurricanes, or a major terrorist event, downward pricing pressures are set to continue during 2004. This is not, however, an indication of a significant "softening" of the market, as many of the insurance industry fundamentals remain a barrier to a significant change in underwriting philosophies resulting in a bountiful supply of cheap reinsurance. Additionally, the Board's property program is in the insurance arena underwritten solely as a catastrophic risk.

G-32

The premium trend is only a part of the entire equation which drives the cost and availability of the Board's property insurance. In addition to more attractive premium rates being offered by most carriers, higher policy limits (capacity) are being made available at these reduced premiums, and in some cases, lower deductibles are also being negotiated. Despite the rebound, however, capacity has not kept pace with the substantial growth in the values insured. According to AON Corporation's 2004 Insurance Market Overview, coverage on a blanket Total Insured Values (TIV) limits basis remains unavailable for most large clients. This is the exact situation that the Board is experiencing as its TIV's continue to increase, which leads to the need to purchase additional amounts of insurance limits as they become available in the marketplace. The balance of increasing limits purchased, while improving the program's terms and conditions, including applicable deductibles, sublimits, and policy provisions, requires an intricate and worldwide marketing approach that aligns the appetites of several different carriers to various portions of the Board's property insurance program.

RENEWAL PROGRAM OUTLINE

The Board's success in being able to insulate itself from the drastic market changes which have occurred over the past three years is based upon the long term business relationships it has fostered worldwide with insurers and reinsurers since Hurricane Andrew in 1992. While the Board experienced significant premium increases and loss of available limits following the terrorist attacks of September 11, 2001, the impact was much less than what many other property owners experienced who did not have these key relationships in place. This combination results in a comprehensive strategic plan to market the Board's program to take full advantage of when the insurance market improves, while limiting the impact to the program when the market deteriorates.

To effectively market the Board's program this year, staff re-evaluated the basis on which the Board's property TIV's are determined for insurance purposes. Since land value is not taken into consideration for insurance purposes, the buildings are valued utilizing an average replacement cost of construction on a per square foot basis, which is then merged with the State of Florida Inventory of School House (FISH) reports. For 2004 the Board's TIV's increased by 6.09% to $4,924,774,305, not including WLRN equipment which includes its antennae and towers.

Since full TIV limits are not available from a capacity perspective, as well as unaffordable, it is necessary to determine the Board's Probable Maximum Loss (PML), to attempt to determine what limits should be attained. The insurance industry has adopted three major models used industry-wide, which when utilized, attempt to determine what the district's property loss would be in the event of another major hurricane. Projections are made utilizing statistics of prior losses and computer modeling of storms. Most models were updated this year to better reflect updated projections, partly because Hurricane Andrew was re-categorized by the Florida Hurricane Commission to a CAT 5, up from its previous category of CAT 4.

The three models which include AIR, RMS and EQE, provide a range of possible property loss amounts depending upon the strength of an anticipated storm, and the statistical probability of that storm hitting Miami-Dade County. For 2004, the range of damages from a hurricane hitting Miami-Dade County in the next year, with a 1% critical probability, run from $180 million to $499 million. Utilizing this model, which is one of the tools all underwriters writing catastrophe-prone business utilize, the model reflects property damages borne by the district which range from $288 million to $871 million, when using the industry-standard 250 year storm (.40%) probability. These loss statistics are what drives the need for higher limits of property insurance, when compared to the Board's TIV's, as recommendations from staff, the Board's insurance consultants, and the banks which underwriter the district's Certificates of Participation (COPs).

Staff, and the Board's broker have structured a renewal program which is being marketed to current and prospective insurers seeking the following major improvements to the Board's program, which will become effective May 1, 2004:

- INCREASE OF PROPERTY INSURANCE LIMITS FROM $500 MILLION TO $700 MILLION
- REDUCTION IN THE HURRICANE DEDUCTIBLE FROM 4% OF AFFECTED VALUES PER LOCATION TO 3% AFFECTED VALUES PER LOCATION
- INCREASED SUBLIMITS OF EXTRA EXPENSE FROM $2.5 MILLION PER OCCURRENCE TO $5 MILLION PER OCCURRENCE
- INCREASED SUBLIMIT OF INCREASED COST OF CONSTRUCTION FROM $20 MILLION PER OCCURRENCE TO $30 MILLION PER OCCURRENCE
- INCREASED SUBLIMIT FOR DEMOLITION FROM $20 MILLION PER OCCURRENCE TO $30 MILLION PER OCCURRENCE

The placement of coverage and negotiations with multiple markets is continuing. The process which has been in place since Hurricane Andrew includes the Board providing authorization to secure and bind the most coverage possible, up to sought limits, effective the renewal date of May 1, 2004, subject to a maximum annual premium expenditure. Last year, staff reported to the Board at the Board meeting of May 14, 2003 with a confirmation of what had been secured and bound, with specifics of coverages, terms, conditions, and final premium costs.

Both domestic, and in particular, London-based insurers have indicated to staff that because of the professional business relationships which have been built in the years subsequent to the Board's $96 million loss from Hurricane Andrew, which resulted in the cancellation of all in-force coverage at that time, ***that requested increased capacity made available by the companies, in conjunction with the requested change in deductibles, terms, sublimits, etc. would be seriously considered with annual premiums for the significantly improved program to not exceed last year's costs.***

Staff and the Board's broker are holding firm during negotiations regarding pricing concessions, changes in deductible levels, as well as other terms. Additionally, the current stand alone Terrorism coverage, which provides coverage for acts covered under the Federal TRIA Act, as well as domestic acts of terrorism not covered by TRIA, is being negotiated with renewals to be at flat premium levels. All negotiations are occurring with the focus of securing the additional $200 million in limits, and lowering the hurricane deductible, while keeping the renewal premium at expiring levels.

The total cost of property insurance, including $500 million in limits for Board-owned property; Board-owned towers, aerials and equipment for WLRN FM/TV, at stated value limits of $12,315,000 and Terrorism coverage with $50 million in limits for the policy period of May 1, 2003 to May 1, 2004 is $21,469,546. Confirmation has been received from London-based leads, and domestic leads to offer the renewal program with applicable improvements, however, meetings are still underway, and will continue through the end of April when staff will meet with key underwriters at the National Risk and Insurance Management Society (RIMS) meeting. This renewal would take the expiring program and increase limits by 40%, reducing the hurricane deductible by 25%, taking into consideration that the Board's total insured values increased by over 6%, at basically the same cost as the Board paid for 2003-2004, subject to changes in State of Florida Fire Marshall fees and applicable surcharges.

Taking into consideration the possibility of securing coverage at the maximum limits sought of $700 million, at the 3% hurricane deductible at expiring premiums bases, authorization is sought to secure and bind coverage with annual expenditures not to exceed $22 million. At the Board meeting of May 19, 2004, a full agenda item will be presented to the Board, confirming the amount of coverage which was secured effective May 1, 2004, as well as other recommendations, including establishment of the annual flood insurance budget, specific to the requirements of the National Flood Insurance Program (NFIP).

Staff received approval from the Superintendent to travel to London to meet with current and prospective property insurance markets for the Board's program, as has occurred over the past several years. Pursuant to the provisions of the Travel Manual, travel expenditures can be approved up to and including $2,500 without Board approval. This trip occurred during the week of February 28, 2004 to March 6, 2004. Travel plans were made well in advance to establish the schedules with the lead underwriters, and take maximum advantage of advance purchasing discounts. This year, however, material changes to the exchange rate for the U.S. Dollar and the British Pounds Sterling, resulting in a very unfavorable exchange rate, which continued to deteriorate from the time the trip was made until completion. This material change, resulted in travel expenses, including the hotel bill, once converted from British Pounds Sterling to U.S. Dollars at an exchange rate of $1.883 to £1, to exceed the established $2,500 threshold. As such, authorization is sought for travel expenses for the trip to meet with London-based lead underwriters, on a program with annual expenditures in excess of $20 million, in the amount of $3,214.11. Funds for this are already budgeted in the travel budget within the Office of Risk and Benefits Management.

RECOMMENDED: That The School Board of Miami-Dade County, Florida:

1. authorize Arthur J. Gallagher & Co., Florida to secure and bind maximum available limits of all risk, replacement cost property insurance coverage, not to exceed $700 million, with annual premiums not to exceed $22 million, effective May 1, 2004, with payment to be funded from its property insurance budget, with a full report, including confirmation of coverages, carriers, deductibles, costs, terms, and recommendations for other property coverage, including flood, as required by Federal Emergency Management Agency (FEMA), to be submitted to the Board at its meeting of May 19, 2004; and

2. authorize expenditures for travel to London, UK, to meet with London-based lead underwriters for renewal terms and conditions, which occurred between February 28, 2004 and March 6, 2004, in an amount of $3,214.11, caused by the significant devaluation of the U.S. dollar, resulting in an unanticipated exchange rate, with such expenditures to come from the Office of Risk and Benefit Management's travel budget.

EM:sc