Office of Superintendent of Schools
Board Meeting of February 11, 2009

January 28, 2009

Financial Services
Richard H. Hinds, Chief Financial Officer

SUBJECT: **RENEWAL OF DISTRICT'S PROPERTY INSURANCE PROGRAM**

COMMITTEE: **INNOVATION, EFFICIENCY & GOVERNMENTAL RELATIONS**

LINK TO DISTRICT STRATEGIC PLAN: **IMPROVE FINANCIAL SERVICES**

The School Board is required to carry property insurance on all school buildings, and all school plants, including contents, boilers and machinery, except buildings of three classrooms or less, pursuant to the provisions of Section 1001.42(9)(b)(8)(d), Florida Statutes. The structure of the District's property insurance program is also of vital interest to the Federal Emergency Management Agency (FEMA) and the financial markets which hold the Master Lease for the District's Certificates of Participation (COP's). Section 5.3 of the master lease states that any policy of all risk property insurance must be obtained from a commercial insurance company or companies rated A+ by A. M. Best Company, or in one of the two highest rating categories of Moody's and S&P, or otherwise approved by the Credit Facility Issuer.

Pursuant to past practice, staff is seeking authority to secure and bind all-risk, replacement cost property insurance coverage, effective May 1, 2009. This advanced authority is sought due to the fact that much of the final placement will occur after the Board meeting of April 22, 2009. An agenda item will be brought to the Board meeting of May 20, 2009 confirming the placement, inclusive of all terms, conditions, premiums, etc.

PROPERTY INSURANCE STRUCTURE FOR 2009-2010

At the Board meeting of May 21, 2008, the Board confirmed placement of the coverage which had been previously authorized at the Board meeting of February 13, 2008 for a total property insurance program with limits of $250 million. The annual cost of this program, including the recommended $50 million terrorism coverage is $24,485,072.37. The Board also authorized a budget for flood insurance coverage for existing and new facilities in flood zones (determined by the Federal Stafford Act) in the amount of $3,500,000.

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Based upon the authorized $65/FTE cap which was in place at the time, approximately $22 million of the total property/flood expenditures was able to be abated to the District's capital budget with the remainder being funded from the District's General Fund. As the Board is aware, as a result of the Legislature's Special Session in January, 2009, the cap has been increased from $65/FTE to $100/FTE, effective July 1, 2008 through June 30, 2010. As a result, it is expected that all property and flood expenditures for the property and flood insurance renewals of May 1, 2009 and May 1, 2010 will be able to be fully abated to the District's Capital Budget.

2008 ATLANTIC HURRICANE SEASON
While the State of Florida was spared any sizable storms during this past hurricane season, the season itself was very active with the first storm of the season, Tropical Storm Arthur forming prior to the June 1 official start of the 2008 Atlantic Hurricane Season. The 2008 season was the third most costly on record, behind only the 2004 and 2005 seasons with up to $45 billion in damages.

There were 16 named storms, resulting in 8 hurricanes with 5 of these hurricanes being classified as major storms of Category 3 or higher. The season was devastating for Haiti, where 800 people were killed by four consecutive hurricanes including Fay, Gustav, Hanna, and Ike. Two major storms caused significant damage in the US including Hurricane Gustav which hit the Louisiana coast on August 31 nearly repeating the catastrophic damage caused by Hurricane Katrina in 2005 when Lake Pontchartrain almost breached the levies, and Hurricane Ike which struck Galveston Island on September 13. Damages from Hurricane Ike are estimated at $31.5 billion, the third most destructive U.S. hurricane on record, behind Katrina in 2005 and Andrew in 1992. Tropical Storm Fay which came into South Florida on August 18 brought much needed significant rainfall to Lake Okeechobee reducing a two year drought. Fay became the first storm in recorded history to make landfall in Florida four times.

WORLDWIDE FINANCIAL CRISIS AND THE INSURANCE INDUSTRY
The current worldwide financial crisis has had a significant impact on the worldwide insurance market, including the markets which underwrite catastrophic-prone areas such as South Florida's windstorm coverages. Some of the largest insurers were caught up in the sub-prime mortgage mess losing billions of dollars in credit swaps which has proved to be a detriment to their ability to underwrite cat-prone coverages. The largest insurance company in the world, American International Group (AIG) received $85 billion as part of the Federal Government's bailout of financial institutions. AIG is comprised of numerous individual insurers each of which are required to carry significant reserves to protect policyholders.

One of the AIG companies is Lexington Insurance Company (Lexington), the largest Surplus Lines Insurance Company in the United States, based in Boston, MA. The Massachusetts Department of Insurance has required Lexington to further strengthen its reserves so there is not presently, nor has there ever been, any risk to the District with Lexington providing $46 million of the total $250 million of all risk property coverage currently in place.

Reinsurers, those companies which insure primary insurers, have seen a significant rise in their exposures based upon the claims from the 2008 Atlantic Hurricane Season and other worldwide catastrophic losses. Demand for traditional reinsurance protection is expected to surge in 2009 as many of the alternative financing vehicles which were being used instead of reinsurance, such as bonds which are issued to cover catastrophic losses (CAT Bonds), have been dramatically reduced.

Primary insurers and reinsurance companies, to maintain their key ratings from rating agencies such as A. M. Best, S&P, and Moody's, have been required to bolster their financial infrastructure, which has lead to pricing increases in the reinsurance markets. This may be a key driver in rates for 2009 renewals of large property owners in catastrophic-prone areas such as Florida for windstorm coverage and California for earthquake coverage.

SELF INSURANCE AND DEDUCTIBLES

As mentioned before, it is being recommended that the premiums for the District's property and flood renewals be paid from the Capital Budget, thus taking advantage of the increased cap on capitalized expenditures. Staff believes that because of significant pressures on the District's total budget, looking at alternatives to save premium dollars is crucial. All available options to reduce expenditures for these coverages entail the Board increasing its risk; therefore, it is important that proper due diligence be conducted to determine the cost of such additional risk. Premium savings can be achieved by the District assuming a higher windstorm deductible, or purchasing less coverage.

With the updated Total Insured Values (TIV) of the District now in excess of $9 Billion, and the fact that current per occurrence policy limits are only $250 million, reducing the level of coverage is not an attractive option.

Not unlike other financial areas such as liability and workers' compensation, use of self insurance assumption of risks play a key role in the structure of the program and maximizing financial opportunities. However, unlike the predictability of liability and workers' compensation losses which can be actuarially determined and therefore properly funded, windstorm risk is not predictable. Therefore, self insurance is used to offset the cost of procuring coverage at lower limits, but exposes the district to financial liability in the event of a major storm.

The District's current windstorm deductible is 4% of values per affected location, subject to a minimum per occurrence deductible of $25 million. Based upon this platform, the Board's risk of loss in a Category 4 or 5 storms could easily result in a deductible in excess of $75 million. Among the options to be reviewed is replacing the current percentage-based deductible with a flat dollar per storm deductible. Based upon Hurricane models which predict losses at different levels, no break in perceived-pricing occurs until a threshold of $100 million per occurrence is reached.

Some models provide few credits due to the fact that in a very bad Category 5 storm, the flat $100 million deductible would be lower than the percentage deductible, thus transferring the risk to the insurers sooner. Regardless of the platform selected, it is crucial for the District not to put itself in a position where the Federal Emergency Management Agency (FEMA) would either limit or deny reimbursement of eligible expenditures.

Following Hurricane Andrew in 1992, the District has sought and received a letter of reasonableness from the State of Florida's Department of Insurance annually. This letter is the District's assurance that the Florida Insurance Commissioner has reviewed and approved the structure of the District's property coverage, including the amount of coverage purchased and deductible levels selected, as required by the Federal Stafford Act. Most property owners in the State of Florida have taken the District's lead in obtaining this letter which provides access to FEMA funding. In the event of a major non-insured loss (under the deductible or in excess of purchased insurance limits) to the District, the District's short-term need would involve obtaining access to cash for repairs whose cost will be eventually reimbursed by FEMA.

In 2008, FEMA announced that it was going to strictly enforce its policy of only reimbursing deductibles on affected properties once. This strategy to reduce FEMA's exposure to properties which may have suffered multiple losses became a huge issue in risk management circles. Large property owners such as Miami-Dade County Public Schools do not have the luxury of purchasing first dollar coverage on previously affected properties due to the fact that the coverage is not readily available in the marketplace. Following a significant "push back" from large employer-based risk management organizations such as the Risk and Insurance Management Society (RIMS) and the Public Risk and Insurance Management Association (PRIMA), FEMA re-stated its position that if a property holder obtained a waiver or letter of reasonableness from the Insurance Commissioner, outlining that first dollar coverage was not available, then FEMA would reimburse losses to previously affected properties. This is a significant break through for large property holders such as Miami-Dade County Public Schools and provides some opportunity to look at deductible options to save money.

TERRORISM INSURANCE ACT AND COVERAGE

On December 26, 2007, then President George W. Bush signed into law H.R. 2761, the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) of 2007, just days before the program was set to expire on December 31, 2007. TRIPRA has played a key roll in ensuring that businesses will have the available and affordable insurance options necessary to protect themselves against the financial consequences of a terrorist event.

Insurance coverage provided by companies, pursuant to the provisions of TRIPRA, eliminates the distinction between foreign and domestic terrorism. Staff is recommending that the District continue to purchase terrorism coverage for its 2009 property renewal as many public entities including Miami-Dade County and other major urban school systems believe that coverage for acts of domestic terrorism is vital.

Last year's renewal premium for $50 million in coverage was $145,440, including state fees, which was reduced from the prior year's premium of $252,504. Staff believes that this coverage can be renewed with no increase in premium and will negotiate for additional premium reductions if possible.

MASTER PROPERTY PROGRAM RENEWAL TERMS

At this time staff is recommending that it seek renewal terms and conditions on the existing coverage platform, including the renewal of existing $250 million in coverage with the current percentage (4%) windstorm deductible. As an option, staff is also recommending that it explore a windstorm deductible alternative of $100 million per occurrence flat. Both avenues can be explored to determine if there is adequate premium savings to offset the possible increased risk of a large deductible for smaller storms. Taking into consideration worldwide property losses in 2008, and the present state of the world's economy which appear to be driving up the cost of reinsurance by as much as 10%, increasing the District's risk for inadequate premium savings does not make good business sense.

Therefore, staff is requesting authority to secure and bind catastrophic, all risk property insurance coverage for all covered properties ($9 Billion TIV), effective May 1, 2009 with total expenditures for property and terrorism coverages not to exceed $25 million. Again, it is staff's intent to attempt to reduce expenditures for such coverage where the cost/benefit of such premium savings does not expose the District to excess risk.

NATIONAL FLOOD INSURANCE PROGRAM (NFIP)

As it has done for many years, staff is recommending that the District authorize a budget in the amount of $3.5 million for flood coverage written through NFIP for those properties in an exposed flood zone. Purchase of this coverage is a requirement of the Federal Stafford Act, which along with the property coverage, provides access to FEMA public assistance grants. Premiums for this coverage are written on a building by building basis and premiums for this coverage can also be paid from the District's capital budget.

STAFF AND BROKER MEETING WITH PROPERTY UNDERWRITERS

The value in meeting with key markets in person cannot be overstated. A limited number of insurers possess needed catastrophic coverage capacity in the worldwide market. Miami-Dade County Public Schools, as one of the nation's largest property owners, must have access to a significant portion of that capacity.

To accomplish this, meetings will be held to not only review the District's current property values and coverages, but to make sure that the underwriters are aware of the extreme nature of the District's financial challenges and what steps the current administration has taken to limit damage to the District's long-term fiscal solvency. Much of the conversation with these markets is the same conversation that occurs with the rating agencies. It is important to remember that the viability of this coverage must be acceptable to the holder of District-issued Certificates of Participation (COP's).

EXPLORING FINANCIAL ALTERNATIVES

The District works through Arthur J. Gallagher & Co. as its broker to obtain its property insurance coverage. State Board Rule 6A-1.012(11) provides the District the authorization to enter into insurance and risk management through direct negotiations and contract. Prior to the current economic crisis, there were financial institutions which had approached the District with alternatives to traditional insurance coverage for its property insurance coverage which was reviewed by staff. Other large property owners including Miami-Dade County, Broward County Schools, and Palm Beach County Schools were also being visited by these institutions.

At last year's property insurance renewal, the Broward County School Board authorized staff to issue a Request For Information (RFI) to explore the viability of any alternatives to traditional insurance for property coverages. Broward County Public Schools issued RFI 29-086V for Property Insurance Services to obtain information from companies to maximize financial recoveries in the event of a loss; maximize eligibility for access to FEMA Public Assistance Grants in event of a loss; and provide results at the most reasonable costs.

A property Insurance Services Review Committee was established to bring together resources to review such proposals and included Mr. Scott B. Clark, Risk and Benefits Officer, Miami-Dade County Public Schools, the only committee member not with Broward County Public Schools.

Proposals were received from the following companies:

- Arthur J. Gallagher & Co. (AJG)
- BB&T Insurance Services, Inc., and McGriff, Siebels and Williams
- Risk Management Associates, Inc. d/b/a Public Risk Insurance Agency (Brown & Brown)
- Employers Mutual, Inc.
- Marsh USA Inc.
- Willis HRH

The committee met on December 1, 2008, and chose to interview three proposers, AJG, Brown & Brown, and Marsh. These three firms were selected to provide additional information to the Committee because, based upon their submissions, they exhibited more extensive experience with similar large property insurance programs and included the more innovative conceptual proposals.

On December 11, 2008, interviews were held with the three companies and the Committee recommended that a contract be negotiated with AJG based upon that company's vast experience in creating property insurance programs with large Florida governmental entities; determination that in the current state of the world's financial condition, purchase of catastrophic property insurance continues to be the best method of protecting the property risk; and the ideas brought forth to gauge various options including deductible levels to maximize coverage, while attempting to minimize risk.

Having key staff involved in this exercise, staff believes that its current broker, AJG, is the best broker for Miami-Dade County Public Schools to structure and renew its property insurance program. Taking into consideration the District's financial situation, the broker commission to AJG for the property placement will be negotiated to achieve appropriate reductions.

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

1. authorize staff, through Arthur J. Gallagher & Company to secure and bind maximum available limits of all-risk, replacement cost property insurance coverage in anticipation of obtaining the existing $250 million coverage limits, with annual premiums for all property insurance premiums and fees not to exceed $25 million, effective May 1, 2009, with payment of such coverage to be funded from the District's property insurance budget, with a full report including confirmation of coverages, carriers, deductibles, costs, and terms to be submitted to the Board at its meeting of May 20, 2009 and;

2. authorize renewal of flood insurance coverage with the National Flood Insurance Program (NFIP), through Arthur J. Gallagher & Co., for all properties required by the Federal Government to be covered with estimated premiums not to exceed $3.5 million for coverages effective for the 12 month period of May 1, 2009 to May 1, 2010.

RHH:sbc