



**CALIFORNIA JPIA**

**BROKER ANNUAL STEWARDSHIP REPORT**

Presented by:

**ALLIANT INSURANCE SERVICES, INC.**

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## MARKETPLACE CONDITIONS

The relatively sharp escalation of rates and reduction in available coverage during the July 2009 renewal cycle essentially abated in 2010 as overall conditions in the property and earthquake insurance marketplace continued to improve throughout the year.

While the ongoing and lingering effect of a severe recession is still evident in a host of unfavorable economic indicators and stubbornly high unemployment, insurance companies continue to operate normally based upon the relationship between underwriting and risk acceptance, low leverage, conservative investment philosophy, and comprehensive federal and state regulation. In short, there is no credit or liquidity crisis for insurers as evidenced by the fact that A.M. Best, the standard industry financial review service, issued affirmations or upgrades of insurer's current ratings four out of five times and issued downgrades less than three per cent. More specifically, a number of insurance carriers have substantially improved balance sheets amid increased first quarter 2010 profits, and the industry now sustains a record high policy holder surplus of \$540 billion and positive return on equity performance benchmarks in distinct contrast to many other companies within the broader financial services industry.

Although insurers' improved financial condition should provide intermediate term support in sustaining marketplace stability, there are some causes for longer term concern as falling written premiums over the past three years and lower investment returns due to overall economic weakness could adversely impact return of equity with resultant capital withdrawal, causing upward premium rate pressures. On a further positive note, the forecasted significant probabilities of the U.S. mainland being struck by multiple powerful hurricanes have failed to materialize; hence the heretofore benign and waning hurricane season will offer additional short term support.

Forecasting prevailing marketplace conditions with specificity into mid 2011 is always subject to unforeseen circumstances and therefore difficult to completely and accurately assess; however, given those developments previously noted and our own recent experience

in direct insurer negotiations, we believe that all risk property and earthquake rates should decrease modestly for the July renewal. To afford further perspective, please note that we have been able to maintain annual all risk and vehicle rates at historical lows for the program, and further significant reductions within the current structure may be difficult to develop in any environment.

Likewise, the pollution (environmental) insurance marketplace has consolidated after a period of declining rates, and we anticipate modest rate reductions at the July 2011 renewal. Inasmuch as there are relatively few viable insurers in this technical and engineering oriented marketplace, conditions can change quickly, either positively or negatively, with little outside stimulus. To underscore that point, several insurers have implemented more stringent underwriting guidelines in 2010 which may increase that volatility.

We anticipate slightly more restrictive marketplace conditions for boiler and machinery insurance as 2010 renewal rates decreased an unanticipated 20% and therefore expect rates to increase modestly.

Ancillary insurance programs such as crime and special events liability are typically unaffected by overall marketplace conditions, and we believe that rates will be approximately the same at renewal, as has been the case during recent marketplace contractions and expansions.

We shall continue to provide periodic updates and assessments of marketplace developments and conditions throughout the year.

## RECOMMENDATIONS FOR IMPROVED PROGRAM DESIGN

Improvements to any program can always be effected; however, we successfully met the considerable challenges of recent difficult underwriting negotiations occasioned by adverse all risk claims development in 2009 and an approximately \$5 million earthquake claim as originally estimated and reserved by the insurer in early 2010. As we were able to maintain the integrity of all risk property and earthquake insurance program policy form coverage and premium rates, there seems to be little need for any significant coverage or price enhancements. The overall design of the program has proven effective in providing broad all risk coverage at competitive premiums as well as the provision of relatively high limits of earthquake coverage in both restricting and softening marketplace environments. The insurance policy form has been specifically crafted to cover unscheduled property and to include unusual coverage for specific cities' exposures, such as piers, residential low income housing projects, bridges, underground pipes, specially trained animals, extensive golf equipment retail sales inventory and landscape including golf courses and athletic fields, roadways, highways, streets, sidewalks, culverts, street lights, traffic signals, errors and omissions, as well as covering the peril of mold on a sub-limited basis, all of which are universally excluded from standard property policies.

We maintain the ability to offer an overall Alliant program to afford terrorism coverage at competitive rates for specific properties, although most members, with few exceptions, do not own facilities which seem to present likely terrorist targets. We will continue to explore the feasibility of the provision of expanded computer and cyber risk coverage in the policy, for which there has been little enthusiasm from insurers and for which there seems to be little loss exposure, as well as enhanced coverage for "green", certified LED properties in light of emerging environmental concerns. If cost effective, boiler and machinery coverage could be included in the all risk policy form, an option that heretofore has not been viable. We will also attempt to expand blanket flood coverage, an option that we have actively negotiated and have been able to provide on a limited basis at the 2009 and 2010 renewals. Placement of the Lexington primary policy on a reinsurance basis, for which we have carrier approval, may develop modest cost savings.

As usual, we shall continue to consider and analyze any viable alternative insurer and reinsurance options and will again comprehensively review the current all risk and earthquake insurance program structure in order to evaluate whether program design alternatives may offer broader coverage options at more cost effective levels. Potential strategies will range from analyzing the single earthquake layer currently in place to multiple towers as previously utilized and will employ the use of an array of computer software loss modeling programs in that analysis. The introduction and subsequent insurance company adoption of new RMS modeling programs assessments may allow us to more aggressively negotiate such options and to establish lower coverage requirements at reduced pricing levels. Various levels of self insured retentions will be evaluated on a risk reward, cost savings to loss exposure basis. It appears that the claim for member city damage sustained in the April 1, 2010 Baja California earthquake may now be in the \$1.5 million range, substantially less than the approximately \$5 million current reserve, and we hope to capitalize on this improved loss ratio by negotiating rate decreases in excess of what we foresee in a modestly more favorable insurance marketplace environment. An ongoing review of all risk property claims and loss history will be employed to develop alternative deductible and/or self insured retention levels and to further identify trends for loss control and cost mitigation programs. These assessments will serve as the basis for discussion and further refinement in concert with Authority staff to subsequently develop optimal strategic renewal objectives and alternative strategies.

We again suggest that the development of additional underwriting information for secondary building characteristics could have a significantly positive impact on earthquake insurer pricing and provision of coverage. While the immediate need for such data is of questionable value given the anticipated improvement in the catastrophic insurance environment and the inherent difficulty of securing information from many different members, it may be a worthwhile longer term risk management goal as difficult underwriting cycles will invariably return at some future point and could be a component of an extensive building valuation and appraisal program currently under consideration.

The concept behind the secondary building characteristic survey prompts further thought of the value of seismic engineering surveys as outlined in a previous program analysis review.

There are several engineering firms who specialize in this discipline and can verify current building seismic resistance capability and/or the need and remedy to effect structural integrity. Although it is normally an expensive project process, it can yield future cost savings as it affords an entity the ability to self insure earthquake exposures or to more easily determine specific facilities to insure.

We will continue to make a concerted effort, as has always been our goal, to more fully educate all Authority members of the benefits and features of the insurance programs and systems which, we believe, will only enhance value to the membership. We have a long standing goal to enhance and streamline electronic communications and to develop efficient and useable online databases.

As the program membership has expanded and more Alliant personnel are now involved in the administrative process, we must continue to strive to provide better communication to the Authority in a cohesive overview format. Specifically, we have recently formalized an internal procedure to eliminate direct member mailing without Authority pre-approval, and are pleased to confirm it has worked as designed. We had earlier suggested that a regularly scheduled meeting or workshop may provide a forum to consider and discuss a number of strategic and tactical initiatives to ensure an ongoing viability of current programs or the development of new programs may be of benefit and would encourage your consideration of the concept. In addition, we have previously suggested and continue to recommend the benefits of a pollution insurance and exposure seminar to further educate the membership on this complex and sometimes difficult to understand discipline and to enhance communication of evolving environmental issues and insurance marketplace conditions.

Although pleased with our development of the Authority's programs, we shall continue to monitor our ability to effectively and expeditiously meet members' needs. We remain committed to effecting ongoing program improvements, creatively developing new programs to address members' emerging needs and exposures, and continuing to analyze program structures to minimize cost in conjunction with risk assumption.

## **SERVICE PERFORMED**

We are committed to proactively and resourcefully addressing the needs of all our clientele given Alliant's stature as arguably the largest diversified public entity broker in California. We are gratified to have served the insurance and risk management needs of the California Joint Powers Insurance Authority since selected by the Executive Committee in 1990. We firmly believe that each of our clients benefit individually from our being broadly involved with many joint powers authorities and individual agencies throughout the state and the country – from our marketing expertise to our innovatively developing new programs to our creativity in using non-traditional funding and risk transfer methods to our authoring legislative changes and reforms.

As previously noted, an improving insurance marketplace had materialized in late 2009 and continued into 2010 as we began negotiations for the all risk property and earthquake renewal program. However, the placement of any large earthquake insurance program requiring world wide insurer participation is a complex task in any marketplace environment and was further compounded by the substantial damage to several member cities generated by the April 1, 2010 Baja California earthquake. Despite the estimated claims reserves of more than \$5 million, we were able to capitalize on the Authority's long term partnership with Lexington Insurance Company to develop a comprehensively competitive primary renewal program – our extensive marketing survey verified that no other insurers would provide comparable coverage capacity, premium rates, terms or conditions. Accordingly, in combination with our aggressive negotiations with excess earthquake insurance underwriters, and in conjunction with our review of extensive earthquake loss modeling simulations and exposures analysis, we determined that the single tower of earthquake insurance implemented last year was still the most cost effective approach and generated an overall rate reduction of seven percent.

Although all risk loss experience had unexpectedly deteriorated, we nonetheless aggressively negotiated all risk and vehicles coverage rate reductions of almost five per cent with Lexington and excess insurers by relying upon long term insurer relationships. Importantly,

we were able to negotiate Lexington's ongoing provision of the \$400,000 all risk deductible aggregate, which will continue to be calculated inclusive of member deductibles in spite of this adverse claims development. Furthermore, we secured Lexington's agreement to provide partial deductible reimbursements on a quarterly basis in order to substantially offset negative cash flow and balance sheet issues for the Authority.

We were also able to maintain the \$10 million blanket flood coverage for members who do not participate in the earthquake and flood insurance program and negotiated a significant twenty per cent reduction in boiler and machinery rates. We believe that the current property insurance program rates are among the lowest in the marketplace, compare very favorably with other Alliant and JPA programs, and are substantially below individual city placements while still providing extremely broad policy terms and conditions with generous claims adjustment provisions.

The establishment of Crawford Technical Services (Crawford was selected best overall third party claims administrator in recent Business Insurance Readers Choice Awards) as the independent claims adjuster a number of years ago has been a cornerstone of our program due to the property insurance claims process being of fundamental importance to member participants. We have expanded the adjuster's role in the administration of the deductible program in order to alleviate additional administrative Authority staff responsibilities and continue to concentrate considerable attention in expanding that role. For example, Crawford has developed an online "client-server" database Claims Tracking System (CATS) – which provides thorough, up to date property claims information and which is also now provided in an Excel spreadsheet format for easy manipulation of data. Authority staff may access a specific claim or all claims, enter file notes, set up diaries and preview or print reports at any time online. The Detailed Claims Register which is the most widely used report, itemizes each member's claims and can be sorted by year, type, date of loss, claim number, open or closed, and amount. The Authority can vary the content of the report from an entire listing of all claims to a very small segment, and numerous options are now being explored to further manage the data.

As further evidence of their ongoing proactive claims adjustment philosophy, Crawford (Ron Elbling) has contacted member cities which may have been impacted by widespread firestorms and rain and windstorms, and most recently, the Baja California earthquake, to offer assistance and suggestions for accessing coverage under the program. In effect, the Authority is able to secure these resources, which in effect are the same as a third party claims administrator at no cost, and Ron's long term relationship with the insurer allows him considerable latitude in quickly resolving and settling claims, frequently to the member's financial advantage.

Our ongoing risk property loss control and engineering program for member participants primarily focuses on the elimination or mitigation of exposure to loss. We believe that this focus has been a substantial contributor to the favorable, long term overall claims experience of the all risk property insurance program and further believe that a review and analysis of specific losses during inspections can reduce the likelihood of future incidents. Inspections have become a critical component of the overall safety program of the California JPIA and serve to identify fire hazards and related loss exposures to properties, thereby protecting member facilities and reducing the ultimate cost of risk. Recent inspections at member facilities have, in fact, revealed numerous such exposures to potential loss:

- Blocked electrical panels
- Lack of fire sprinkler system testing
- Sprinkler systems lacking 5-year certification
- Blocked fire sprinklers
- Unsecured fire control valves
- Unmarked exit doors
- Missing halon type fire extinguishers in computer rooms
- Ground faults missing in electrical outlets near water sources
- Dry chemical system in kitchen area needs replaced
- Kitchen exhaust hood and ducts need cleaning
- Lack of fire extinguishers and/or unmounted fire extinguishers

- Fire extinguishers should be inspected and tested annually
- Expired elevator permits
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Written reports with recommendations for property protection are provided to members with copies to California JPIA staff. We will continue to survey select member locations throughout the policy period and are committed to serving the membership on any property related loss control questions, issues, or concerns.

Pollution liability insurance provides coverage for third party claims alleging bodily injury and property damage (including cleanup) arising out of pollution conditions at or migrating from member owned and leased locations or arising from member operations (such as police, fire and public works departments). Coverage extensions include on-site cleanup of pollutants whether or not a cleanup order is issued by a regulatory agency and coverage for above ground storage tanks, scheduled underground storage tanks, scheduled non-owned disposal sites, streets and roads, storm drain outfalls, sanitary sewer trunk lines, newly acquired property, bodily injury as a result of lead based paint and asbestos, water products, and mold coverage (as an option). In addition to these program specifics, we have been able to address specific member needs of the California JPIA relating to non covered exposures. For example, a limited number of cities have cited the need to cover personnel and vehicles involved in hazardous material handling, and we have developed specific endorsements to afford such coverage at minimal or no additional premium. We have also addressed various regulatory issues and questions as it relates to the specific entities operations such as the MCS90 (hazardous waste haulers license) requirements.

A renewal marketing overview and timeline strategy has been developed and provided to Authority staff for initiation in January in order to effectively capitalize on favorable pollution insurance marketplace conditions and to counter the recent trend of increased member claims frequency. Concurrently, we have continued to monitor the improving financial condition of the current program insurer, XL Environmental (Indian Harbor Insurance Company) and have provided periodic updates as warranted.

In order to assure efficient communication in the event of loss, we have established a twenty four hour a day toll free telephone number for members to report incidents. Furthermore, we have now assigned a dedicated claims representative in our San Francisco Office to facilitate and manage the claims adjustment process between the member and the insurance company to ensure effective and timely handling. Our overarching philosophy is the immediate and aggressive response of the insurer to potential loss, and we tailor our interaction with both the member and insurer to meet that goal.

We have provided various newsletter articles for the California JPIA quarterly newsletter on the pollution insurance sector working closely with the Authority, we continue to develop improved methods of communicating information to the membership on environmental issues, market conditions, and recent and pending regulatory changes, as well as providing links to pertinent websites that detailed information on this often obscure topic.

Our crime program continues to offer broad coverage for all employees under one blanket bond – employee theft including faithful performance of duty, forgery or alteration, theft of money and securities inside and outside the premises, robbery or safe burglary inside and outside the premises, computer fraud, funds transfer fraud, money orders, counterfeit and paper currency. We undertook the design of the Authority’s master crime program when it became apparent that many member cities were only insuring elected or appointed officials on individual public official bonds or carried only minimal coverage, if any. In many cases these individual policies only afforded employee dishonesty, without faithful performance of duty or the broad coverages listed above. Initiating the crime program with approximately one dozen participants, we are now pleased to advise that there are 101 member participants with each entity having dedicated limits of coverage from \$1,000,000 to \$10,000,000 with a \$2,500 deductible. We were able to negotiate slight rate decreases at renewal, and the program costs are well below individual policy premiums at significant group purchase cost savings while still providing comprehensive coverage extensions.

Our special events liability insurance program is widely used by the membership (currently 98 member participants) as an effective risk transfer technique. We market the program annually in order to verify competitive rates and have been able to maintain consistent rates and hazard classes with Evanston Insurance Company for the January renewal. The program is managed without the need of an application process with the exception of entity sponsored events (Nominee Events) and the requirement of prior approval on certain events outlined in the program manual. The excess accident medical coverage was expanded in 2009 to include the majority of event participants for all sections of the program. Participants and Performers AD&D and Accident Medical Coverage can be provided subject to underwriting approval.

Other unique programs, such as Special Liability Insurance (SLIP) and Special Property Insurance (SPIP) were created to respond to the needs of newly established, small agencies created in the aftermath of California Proposition 13, and provide competitive premiums and coverage terms for smaller non-profits and other related entities falling under the “corporate” authority of public entities. These programs offer the substantial benefits of low deductibles and/or provision of coverage to affiliates of members not otherwise eligible for inclusion in the Authority programs and have been used effectively by several member cities. A number of other members participate in our vendor general liability insurance, aviation liability, and personal lines insurance programs.

We remain committed to technology solutions that enhance service to our clients and, have initiated steps to increase the integrity and protection of our data through improved processes to support our internal security. We have significantly automated and enhanced account administrative functions to directly save the Authority significant administrative expense, and we constantly consider and analyze different approaches for more effective administrative functions. For example, we are currently developing a new vehicle database system, which may soon be alpha tested. We have fully converted the renewal information process to an electronic basis and have therefore eliminated a paper intensive, administratively burdensome process.

Our Insurance Requirements in Contracts Manual (IRIC), December 2007, Version 6.0 is online and accessible at any time (updated version pending approval to soon be released). This manual was originally developed as a public domain document and is updated on a regular basis in order to provide current general guidelines appropriate for public agencies and has proven to be an effective tool in assisting Authority risk managers and city attorneys in the design, implementation, or interpretation of various contracts.

Given the size and complexity of these programs, it is understandable that we allot a minimum of eight hours per day or more of primary service representative staff time to service the Authority's account. We have expanded our staff to specifically reassign the Authority as the primary account within a unit of only JPAs. Below, we identify individuals within the unit and their estimates of service time.

**Total Support Staff (Direct):**

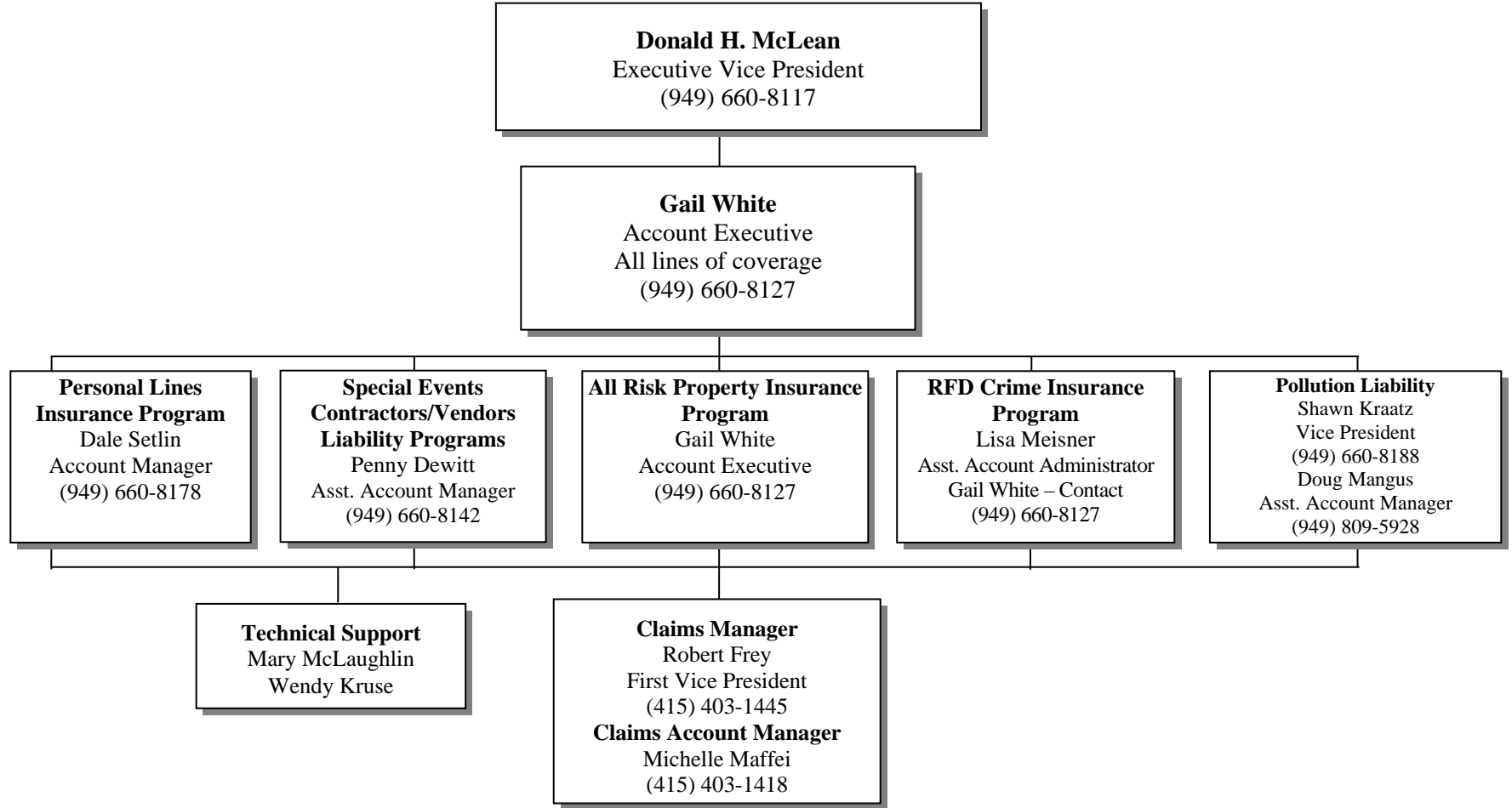
Account Executive	(100%)
Loss Control / Contract Engineering	( 25%)
Account Assistant	( 25%)
Claims Administrator	( 25%)
Word Processor	( 25%)

We believe the reorganization of our office has been beneficial to the Authority as there are now more individuals involved in the administration of the account.

As always, we remain committed to being immediately responsive in meeting the ongoing needs and concerns of the Authority and its members. We continue to offer on-site meetings throughout the year with individual city members to discuss all Authority programs, coverages, and administration. Alliant hosts online, no cost "webinars" on a monthly basis addressing current best practices and ideas for improving risk management programs which we have made available and can still offer to the Authority. We pride ourselves in being

available, often on short notice, to meet with individual city representatives and we firmly believe that most members will attest to our service commitment and understand that we are proactively and proprietarily committed to their service needs.

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