May 22, 2012

Ms. Jean A. Farris, C.P.P.B.
Supervisor of Procurement
City of Rochester Hills
1000 Rochester Hills Drive
Rochester Hills, Michigan 48309

Dear Ms. Farris:

Subject: RFP-RH-11-061, Property/Casualty Insurance, Award Recommendation

We have examined the cost proposal forms submitted by The Ibex Insurance Agency, which presented a proposal using the Michigan Municipal Risk Management Authority as its coverage provider, and Nickel and Saph, which represents Trident and Chartis.

This process was a rather lengthy and involved one, and it required fairly comprehensive proposals from each of the initial participants, very detailed proposals from the two participants which submitted proposals, and responses to a number of follow-up questions. All of this takes time, and, of course, one proposal only is successful. We recommend that this process be done on a six-year cycle, which allows time for the successful participant to recoup the costs of submitting a proposal. When full proposals are sought more frequently, it is likely that fewer and fewer participants will be interested.

An examination of the proposed coverage costs for 2012-13 alone shows that the cost of the Nickel and Saph proposal is about $58,000 less than that of the Ibex proposal. However, it is impossible to evaluate the cost in a vacuum; we will comment more on this below.

The Nickel and Saph proposal states that an application must be completed and submitted by the City within 30 days of the coverage binding date. Coverage would be bound as of July 1, 2012, and the application must be completed by July 31. While the agency, no doubt, would complete as much of the information as possible, it will require the time of City employees to examine the application for completeness and accuracy.

The two proposals are not completely comparable. Although **Property** coverage is the most comparable, even these are not exactly alike. For example, although M.M.R.M.A. requires a schedule of locations for underwriting, the coverage document does not limit coverage to scheduled locations. The Nickel and Saph proposal limits insurance to scheduled locations, with a small amount, $50,000, for property off-premises. M.M.R.M.A. uses this unscheduled locations and the $1,000,000 **Transit** limit to cover equipment, such as excavation equipment and repair trailers, while out on a job site. Trident covers this equipment, provided that it is scheduled or is newly-acquired and reported within 90 days of acquisition under a separate coverage agreement, to separate blanket limits by class of property.

A single blanket limit was requested, but Trident offers two blanket limits, one for buildings and one for personal property. While this is not the single limit which M.M.R.M.A. provides, the two separate blanket limits are not likely to be of concern because of the geographic dispersion of City locations.

A word about coinsurance is in order. A coinsurance clause is included in a **Property** policy in order to encourage insurance to full value. Suppose that a building owner owns a building with a replacement value of $100,000. The owner, thinking that no loss will exceed $50,000, buys a $50,000 policy on the building, but the policy has a 100% coinsurance clause. A $30,000 loss occurs. The insurer compares the amount of insurance in force with the value of the building, and calculates that the amount of insurance was 50% of what was required to satisfy the coinsurance requirement. The insurer therefore pays 50% of the loss, or $15,000, less deductible.

The Nickel and Saph proposal includes two coinsurance clauses. The first applies to buildings and personal property, primarily building contents. If the total amount of insurance does not equal at least 90% of the full replacement value of the covered property, a coinsurance penalty will apply. The R.F.P. requested application of the *Agreed Value* clause, which eliminates any possible coinsurance penalty. The agency responded by stating that an appraisal of City property is required in order to suspend the coinsurance provision. Depending upon a number of factors, the cost of the appraisal could range from $10,000 to $25,000, which, of course, must be added to the cost of the proposal. Further, until the appraisal is completed and given to the insurer, the coinsurance clause will still apply.

The second coinsurance clause is found in the Trident *Equipment Protection Endorsement*, which covers various types of items, such as heavy equipment, items in the Van Hoosen Farm Museum, and other equipment which is mobile. Such equipment must be insured, by category, to at least 90% of actual cash (depreciated) value of such equipment, or a proportionate reduction in recovery will apply.

While both Ibex and Nickel and Saph offer a full blanket limit applicable to covered property, the Nickel and Saph Trident proposal imposes yet another limitation, called a *margin clause*. This provision states that, although a blanket limit applies, any loss payment is limited to 125% of the amounts shown on the most recent *Statement of Values* for each location. Thus, if a location were reported with a building value of $100,000 and contents valued at $50,000, any loss at that location is limited to $125,000 for the building and $62,500 for contents, the blanket limits notwithstanding. This provision will disappear upon completion of an appraisal, at an additional cost estimated above.

General Liability coverage was quoted with a number of variations, but neither proposal included an annual aggregate limit on the deductible or retention. Thus, any deductible or retention applies to each and every covered event.

The M.M.R.M.A. proposal submitted by Ibex is virtually identical to the coverage which the City has had. A $15,000,000 limit applies to each event, with a $500,000 coverage year aggregate limit applicable to sewage system overflow events. Each covered event is subject to a $150,000 self-insured retention, which means that all damages and claim expenses which are allocated to a specific event are first paid out of the retention amount, with the applicable limits providing excess coverage. The retention amounts are funded, which means that part of the cost for coverage is set aside to pay retained amounts; this is one reason why the initial cost of M.M.R.M.A. coverage is higher.

As we have noted in the past, there are some drawbacks to the M.M.R.M.A. coverage document, which is about fifteen years old. The pollution exclusion and coverage for volunteer injury are more limiting than those of the "standard" **Commercial General Liability** coverage form. However, the M.M.R.M.A. by-laws provide that any coverage interpretation by the M.M.R.M.A. Executive Director supersedes the language of the coverage document. The City has received a letter from the Executive Director which affirms that the provisions of the proposal are considered to be included in the coverage provided. This ameliorates some of these limitations. Nevertheless, we prefer that the coverage document be updated.

The Nickel and Saph Trident proposal uses the "standard" **Commercial General Liability** policy form, with amendments. Combined with the proposed **Excess Liability** insurance, the requested limit is provided, but it is an aggregate limit for the coverage year. The R.F.P. requested that separate aggregate limits apply per location, but the proposal does not offer this extension. Further, the Nickel and Saph proposed policy form contains a complete pollution exclusion, which is even more restrictive than the M.M.R.M.A. pollution exclusion.

M.M.R.M.A. provides a combined **Automobile** and **General Liability** coverage arrangement, while Trident uses two separate policy forms. Except for the more restrictive pollution exclusion in the M.M.R.M.A. coverage document, both are equally acceptable. It is highly unlikely that the a pollution event will be covered under **Liability** insurance in Michigan. M.M.R.M.A. proposes a $150,000 retention, while Nickel and Saph propose a $50,000 deductible.

Both proposals include Michigan "**No-Fault**" coverages to statutorily-required limits. The $150,000 retention does not apply to any "**No-Fault**" payments by M.M.R.M.A. Trident proposes a $50,000 deductible to "**No-Fault**" coverages, but we believe that this is in error. State law prohibits an insurer from imposing **Personal Injury Protection** deductibles in excess of $300.

The discussion of **Automobile** physical damage coverage is complicated by how M.M.R.M.A. provides it. All autos, except emergency vehicles, are covered under the **Liability and Motor Vehicle Physical Damage Coverage Document**. Emergency vehicles are covered under the **Property and Crime Coverage Document** to amounts per schedule on file with M.M.R.M.A. The maximum recovery is the least of repair cost, replacement cost, or scheduled value. Each automobile, other than emergency vehicle, loss is subject to a $1,000 deductible, plus a retention of $15,000 per vehicle, $30,000 per occurrence. In the event of a single-vehicle loss, the City must pay $16,000 before M.M.R.M.A. coverage begins.

Under the Trident proposal, all automobile physical damage insurance is written on a single policy with the **Automobile Liability**, "**No-Fault**," and **Uninsured/Underinsured Motorists** coverage. Specific valuation for emergency vehicles is provided, with provisions similar to those of M.M.R.M.A. Trident's deductible options are $1,000 or $2,500.

Finally, as respects **Crime** coverage, we are somewhat wary of M.M.R.M.A.'s lack of **Computer Fraud** or **Funds Transfer Fraud** coverage, although M.M.R.M.A. advises that these hazards are covered under its existing **Money and Securities** coverage. All **Crime** coverage, including **Employee Dishonesty**, is included with **Property** coverage, and the applicable deductible depends upon the **Property** deductible selected.

Nickel and Saph have used Chartis to provide **Crime** insurance; Trident was unable to meet the required limits. We find its proposal to be acceptable.

While the costs for 2012-13 are appreciably lower under the Nickel and Saph proposal, we are troubled by the application of the coinsurance and margin clauses to the **Property** proposal, which provisions will not be suspended until the City selects and completes an appraisal of its property. The separate, unremovable coinsurance clause applicable to any scheduled items, such as heavy equipment, is not favorable, either. These drawbacks are not found in the M.M.R.M.A. proposal, and we therefore find the M.M.R.M.A. proposal to be more favorable.

As noted above, the 2012-13 cost amount provided by M.M.R.M.A. includes some funding for claims within your retentions. If we assume that an amount equal to the Nickel and Saph **General Liability** deductible, $50,000, were attributable to claims and expenses, the coverage costs for M.M.R.M.A. would be $340,864 and $332,937, respectively. For such a small difference in annual cost, we would not recommend a change in coverage providers.

The other major factor in this process is an additional amount which each of the proposers was asked to provide, if applicable. M.M.R.M.A. proposes a $477,226 asset distribution, which is a return of contributions based upon a number of factors, including loss experience and investment results. Nickel and Saph included all premium discounts, dividends, and other cost advantages in the premiums which it quoted. Were the City to accept the Nickel and Saph proposal, it would forego the asset distribution which amounts to more than the coverage charge for 2012-13.

The coverage, cost, and asset distribution lead us to recommend that the City remain with M.M.R.M.A. as its coverage provider. M.M.R.M.A. is not an insurer, and therefore is not rated by the major insurance company rating agencies, such as The A.M. Best Company. Although its financial statements are filed with the Michigan Insurance Commissioner, the state performs audits on group self-insurance pools periodically only, not every year. We encourage you to examine M.M.R.M.A.'s audited financial statements carefully to be assured of M.M.R.M.A.'s long term viability.

We attach a spreadsheet which summarizes the proposals and gives a comparison with the 2011-12 coverage year. On that sheet, we also provide a cost summary based upon options which we recommend. We recommend two changes from the current coverage:

1. Consider the $10,000 **Property** and **Crime** deductible. The cost difference between these two deductibles is more than the $9,000 difference between the deductible amounts. Unless the City has multiple losses greater than $1,000 each year, the $10,000 **Property** and **Crime** deductible is more economical.

2. Consider dropping **Automobile** physical damage coverage. As we pointed out in our discussion, above, the City's cost for a one-vehicle event is $16,000 before coverage applies, and is about $32,000 for a two-vehicle event. Although this leaves the catastrophic exposure of multiple autos parked at a single location, that exposure, we understand, has not been the subject of any losses over the recent past.

Acceptance of the alternatives suggested above reduces the City's cost by about $36,000 for coverage, with some of that amount possible taken by loss payments.

Cordially,

Kenneth Bush, A.R.M., C.P.C.U.
Executive Vice President

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