LA DWP Los Angeles Department of Water & Power

BOARD LETTER APPROVAL

RESOLUTION NO. ___________________

Ann M. Santilli
Ann M. Santilli (Feb 18, 2025 08:21 PST)

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Chief Financial Officer

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CEO and Chief Engineer

DATE: February 12, 2025

SUBJECT: Authorization to Pay Excess Liability Insurance and Wildfire Insurance Premiums

SUMMARY

Attached is a Resolution authorizing payment of premiums for Excess Liability Insurance, purchase of Wildfire Catastrophe Bonds (CAT Bonds), utilizing and funding a captive cell for non-wildfire claims, and continued funding of LADWP's Wildfire Self-insurance Trust Fund, all for a total not to exceed amount of $95 million.

LADWP's Excess Liability Insurance Program contains two separate towers: one for non-wildfire insurance and one for wildfire insurance, and each tower operates independent of each other. Through establishment of these two towers, losses in one area will not erode the limits in the other in a given policy year. An excess liability policy is a policy that sits above a self-insurance retention or a primary insurance policy to provide a higher level of insurance coverage.

The Wildfire Insurance Program limits apply to LADWP and to the Pacific DC Intertie Project (Sylmar Converter Station) while the non-wildfire limits cover LADWP and those projects for which LADWP has operating agent responsibility (Pacific DC Intertie, McCullough Switching Station, Mead-Adelanto Switching Station, Airway, and the SCPPA projects: Apex Generation Station and Linden Wind Farm). A separate Non-Wildfire Excess Liability Insurance policy is procured for the Intermountain Power Project and reimbursed by the Intermountain Power Agency (IPA).

Risk Management desires to maintain the current limit of $160 million for non-wildfire coverage and maintain a minimum of $205.5 million in wildfire coverage.

In addition to procuring traditional commercial insurance to cover these exposures, Risk Management would like to (i) maintain the authority to purchase CAT Bonds to replace any high-priced insurance layers in the Wildfire Insurance Program when the availability and price for CAT Bonds presents a more reasonably priced option than traditional

insurance, (ii) explore the use of a captive cell to replace our primary layer of non-wildfire insurance that is provided by AEGIS insurance, and (iii) fund the LADWP Wildfire Self-Insurance Trust.

A CAT Bond is an insurance linked bond controlled by pre-determined triggers or loss limits and pays based on a catastrophic event, such as a major wildfire, exceeding the loss limits established within the CAT Bond.

A captive cell is an alternative risk transfer option used by companies to finance their own risks by setting up their own self-insurance vehicle that receives actuarial and other administrative services through the captive provider and provides lower costs and greater control over coverage than the commercial insurance market can provide. Through a captive cell, LADWP would enjoy the benefit of a funding model based only on LADWP loss models instead of a global model for pricing which may lead to lower pricing than that in the commercial insurance markets.

A Self-insurance Trust is a trust fund established through the Financial Services Office (FSO) with guidelines to ensure that any disbursements are properly documented and in accordance with the trust requirements. With Board approval, LADWP established its Wildfire Self-Insurance Trust Fund in 2024 to help fund the costs associated with wildfire-related damage caused by LADWP's operations or equipment.

Excess Liability policies, CAT Bonds, captive cells, and self-insurance trusts are each a form of risk transfer that can be used to complete a well-rounded liability insurance program and provides flexibility in choosing the type of coverage that best meets LADWP's needs.

City Council approval is not required.

MARKETING EFFORTS

The insurance coverage and policies included in the LADWP program are competitively marketed by LADWP's broker, who was also selected through a competitive RFP process. This year's marketing is expected to be particularly challenging due to the frequency and severity of wildfire losses in recent years in the western part of the USA, the contraction of capacity in the marketplace and the recent Los Angeles wildfires which have created further panic in the market, resulting in exorbitant rates and a significant reduction in commercial insurance capacity. As a result, AON Risk Insurance Services West, Inc. (AON) and Risk Management intend to negotiate the best insurance limits available for a reasonable cost up to and until the policy inception date of April 1, 2025, while also weighing alternative risk transfer programs such as CAT bonds and captives to create the best insurance structure for providing non-wildfire and wildfire coverage.

The current policy expires on April 1, 2025. It is expected that California Wildfire insurance capacity will continue to decrease, while rates, deductibles and retentions will continue to increase, particularly considering the catastrophic Los Angeles wildfires in January 2025. Many insurance markets have indicated that they will discontinue wildfire coverage in the western states or increase retention requirements which will create significant pricing level increases for this year's renewal. On the non-wildfire side, LADWP has experienced several electric contact claims which will affect LADWP's rates on its primary insurance layer causing a potential increase of 25 percent or more resulting in a possible cost of $33 million just to obtain a primary layer of $35 million in coverage which amounts to the equivalent of "ninety-four cents on the dollar" for this initial layer of the insurance tower. This sort of pricing level is no longer risk transfer.

The Wildfire portion of LADWP's insurance policy has traditionally consisted largely of the industry mutual insurance carriers, AEGIS and EIM. However, EIM discontinued offering Wildfire insurance coverage for California and other western states in 2022 and as of 2023, AEGIS no longer offers wildfire coverage in California.

Additionally, AEGIS significantly increased pricing to the point that their primary layer of commercial non wildfire insurance is basically unaffordable. For these reasons, FSO/Risk Management, purchases Wildfire CAT Bonds, when feasible, and proposes to utilize a captive cell for non-wildfire and other coverage types, and continue to fund a Wildfire Self-insurance Trust.

At the conclusion of the marketing period, this insurance will be renewed only after evaluating all the pricing models and coverage terms to determine which will provide the most cost-effective approach for LADWP. A marketing summary for this year's renewal will be made available upon request.

RECOMMENDATION

It is recommended that the Board of Water and Power Commissioners (Board) adopt the attached Resolution authorizing payment of premiums for Commercial Excess Liability Insurance, the purchase of Wildfire CAT Bonds, utilizing and funding a captive cell, and continued funding of the Wildfire Self-insurance Trust which specifically provides for the coverage and payment of wildfire claims.

ALTERNATIVES CONSIDERED

Non-wildfire – for the last four years, LADWP has exercised the use of co-insurance to try to reduce the cost of non-wildfire insurance. Without co-insurance, the premium cost is at $33 million for a coverage amount of $35 million. With co-insurance the premium drops to $16 million, however, if a claim occurs, LADWP would need to pay 50 percent of a full $35 million primary layer claim ($17.5 million) plus the $3 million deductible. In the end, on top of a $16 million premium, LADWP pays another $20.5 million for a claim while the insurance company only pays $14.5 million. This is an alternative that no longer works for LADWP. So far in the marketing, we have not found another insurer willing to replace AEGIS and take the lead as the primary layer lead insurer. The cost for the primary layer of non-wildfire insurance has become prohibitively high and commercial insurance is no longer the best option for LADWP. Therefore, a captive cell to cover the primary non-wildfire insurance layer must be considered as an alternative.

FINANCIAL INFORMATION

Risk Management and AON have been vigilant in monitoring the market conditions. As our broker, AON will diligently continue to market the Excess Liability and Wildfire Insurance risks to the global insurance marketplace up to the renewal date of April 1, 2025. Thus, it is necessary to present this Board item on a “not-to-exceed basis”, allowing the broker to continue its marketing and negotiating efforts up to the actual binding of the policy. While many of the larger utility companies purchase insurance with limits as high as $800 million and pay premiums excess of $300 million or fund a captive to cover all their insurance costs, it is Risk Management’s and the broker’s goal to maximize the breadth of coverage while minimizing costs. Risk Management is requesting authorization as follows:

- The total cost of insurance and other risk management alternative options under this Resolution shall not exceed $95 million including taxes and fees for the 2025-26 policy year. This estimated amount incorporates the purchase of excess commercial insurance for Wildfire and Non-Wildfire coverage, Wildfire CAT Bond premiums, payments for the use of a captive cell, and the continued funding of the Wildfire Self-Insurance Trust while obtaining the maximum possible limits, at a reasonable cost, based on marketing results and pricing.

- As the cost of traditional insurance continues to escalate, Risk Management requests authorization to implement the combination of traditional insurance, CAT Bonds, co-insurance, self-insurance, a Wildfire Self-insurance Trust and a non-wildfire captive cell to maintain sufficient coverage for both the wildfire and non-wildfire towers.

Risk Management is requesting Board approval in anticipation of higher insurance premium costs due to the current liability insurance marketplace conditions. This authority will address any anticipated premium increases and support our effort to maintain the existing policy limits and retentions.

BACKGROUND

Excess Liability Insurance provides coverage for LADWP's third-party liability claims arising from both Water and Power operations. The policy responds to both Wildfire and Non-Wildfire liability losses.

The electric utility industry has experienced large general liability losses as well as multiple wildfire losses which will affect the cost of insurance industry wide. Unpredictable dry brush drought conditions in the western states and the availability under California Law of the inverse condemnation cause of action continue to significantly impact the cost to utilities for purchasing Excess Liability and Wildfire insurance. Since 2017, insurance premiums have increased steadily and for 2025-26 premiums are expected to continue to increase.

ENVIRONMENTAL DETERMINATION

Determine item is exempt pursuant to California Environmental Quality Act (CEQA) Guidelines Section 15060(c)(2). In accordance with this section, an activity is not subject to CEQA if it will not result in a direct or reasonably foreseeable indirect physical change in the environment. The renewal of the Excess Liability Insurance Policy and Wildfire Insurance Program will not result in any physical change in the environment; therefore, this activity is not subject to CEQA.

CITY ATTORNEY

The Office of the City Attorney reviewed and approved the Resolution as to form and legality.

ATTACHMENTS

- Resolution