INFORMATION MEMO

Reducing LMCIT Premium Costs

Explore ways in which League of Minnesota Cities Insurance Trust (LMCIT) members can reduce premium costs. Understand the effect of reducing costs and other important considerations.

RELEVANT LINKS:

I. Liability coverage

A. Consider dropping medical payments coverage

Coverage B of LMCIT's liability coverage, or the "medical payments" coverage, provides a limited amount ($1,000) of no-fault coverage for medical treatment for those injured on city property because of a condition in the property.

The medical payments coverage really only comes into play in situations where the city is not legally liable for the injury (if the city is legally liable for the injury, it will be covered as a liability claim). In many cases, the medical payments coverage is really just paying costs that would otherwise be covered by the individual's own health insurance. Dropping the medical payments coverage can reduce the liability premium by about a percentage point or so.

B. Consider not waiving the statutory tort liability limits

LMCIT gives the city the option of whether or not to waive the statutory liability limits. Liability coverage is more expensive if the city waives the limits; the cost difference is 3.5% of liability premium for members that choose to waive. Waiving the limits does not give the city any better protection; the benefit is only to the party who is making a liability claim against the city.

C. Don't purchase unnecessary "specialty" liability policies

There are some instances where cities are purchasing specialty policies from private insurance companies for risks the city's LMCIT liability coverage already covers. If your city is buying any of the following as a separate policy, you should carefully review why you're doing so:

145 University Ave. West
Saint Paul, MN 55103-2044

www.lmc.org
(651) 281-1200 or (800) 925-1122

RELEVANT LINKS:

- Police liability
- Firefighters professional liability
- Ambulance professional liability
- Public officials liability
- Employment practices liability
- Employee benefit liability
- Fiduciary liability for relief associations
- Fire relief association bond
- Cyber or data security breach liability

D. Consider dropping optional no-fault sewer backup coverage

LMCIT's optional no-fault sewer backup coverage reimburses homeowners for damages caused by a sewer backup, irrespective of whether the city was negligent and legally liable. While many cities feel this is a value added benefit for citizens, it could be an option to consider eliminating it during tight budget times.

The cost of this coverage varies greatly by member as it is based on the number of sewer connections and the limit selected, among other things, but premiums can range from as low as $100 to as high as $20,000 or more. (The base rates are as follows: $1.79 per connection for the $10,000 per building per year limit, $2.11 per connection for $25,000, and $2.63 per connection for $40,000.)

E. Potential savings related to service contracts

LMCIT Liability Rating System

Under LMCIT's liability rating system, there are two areas where cities can potentially reduce their liability premium if service contracts are arranged in a manner that adequately reduces the city's liability exposure.

1. Law enforcement contracts

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LMCIT Contract Review Service.

If a city is contracting for law enforcement services with a county or some other entity, LMCIT will make a charge for the police liability exposure (based on number of officers), unless the law enforcement contract adequately transfers the risk away from the city that's receiving the service. If the entity that is providing the service agrees to defend and indemnify the city receiving the service for claims arising out of the services performed under the law enforcement agreement, LMCIT will forego the police liability premium charge for the city receiving the service. The contract needs to be sent to LMCIT for review.

RELEVANT LINKS:

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2. Other service contracts

Another component of the liability rating system is based on a city's annual expenditures. For certain types of service contracts that adequately transfer the risk away from the city receiving the service, LMCIT can forego including the expenditures associated with that contract from the rating basis. The base rate for liability premium associated with annual expenditures is about $1 for every $1,000 in annual expenditures. A large contract in the $2 million range, for example, could potentially save the city a couple thousand dollars in liability premium if it is submitted to LMCIT and if it is set up in a manner that adequately reduces the city's liability exposure.

II. Property coverage

A. Don't cover rented buildings

When the city leases a city-owned building to a private party, the lease agreement may require the renter to insure the building. There are occasionally situations where the city nevertheless also schedules the building under the city's property coverage as well, in order to protect the city in case of any problem with the tenant's insurance. If you have a building leased out and the tenant is insuring it, and if you have assurance that the tenant has the needed insurance and that that insurance protects the city's interest, you could drop that building from the city's coverage. (Of course, you'd have to make sure to remember to add it back if the lease were terminated, or the tenant lost coverage, and so on.)

B. Report vacant buildings

If a building is vacant, it's covered only for actual market value, not replacement cost. The premium for a vacant building is also based on market value rather than replacement cost, but a higher rate is used to reflect the higher risk. Depending on the circumstance, the actual premium for a particular building could increase or decrease when that building becomes vacant. When a covered building becomes vacant mid-term, LMCIT will give the city the premium credit right away if there's a premium decrease. If there's an increase, LMCIT will waive the increase until the city's next renewal. Remember, when a building becomes vacant, the coverage automatically switches from replacement cost to market value even if the city hasn't reported to LMCIT that the building has become vacant.

RELEVANT LINKS:

LMC information memo, *National Flood Insurance Program.*

LMC information memo, *Extraordinary Expense Coverage.*

LMC information memo, *Coverage Options for Municipal Electric Utilities.*

LMC information memo, *LMCIT Auto Coverage Guide.*

C. Use a high deductible on NFIP flood coverage

Compared to other types of property insurance, the National Flood Insurance Program (NFIP) flood insurance is expensive. In some cases, cities are required to carry NFIP insurance on certain buildings as a condition of disaster assistance that the Federal Emergency Management Agency (FEMA) provided in the past. NFIP offers optional deductibles of up to $50,000, which can reduce the premium by up to 50%. If flood damage occurs, the city can use LMCIT's extraordinary expense coverage as a way to finance its cost under the deductible.

D. Review replacement cost values for electric generation facilities

LMCIT offers agreed amount replacement cost coverage for generation facilities. Briefly, under this option, the coverage limit and the premium are based on the cost of providing the generating capacity the utility needs, rather than on the cost of replicating the actual facility the utility currently has. This might make sense in a situation where the utility's existing facility has significantly more capacity than what the utility actually needs, or in a situation where a different and newer technology can provide the same generating capacity for less than the cost of replicating the existing facility's older technology.

III. Auto coverage

A. Drop auto physical damage coverage on older, low-value vehicles

LMCIT automatically provides auto physical damage coverage on all city vehicles unless the city specifically opts not to cover specific vehicles. If you have some older, relatively low-value vehicles that are not critical to the city's operations, consider deleting them from the auto physical damage coverage.

B. Drop primary auto liability coverage on private vehicles used on city business

The city has the option to make the LMCIT auto liability coverage primary when a city employee uses his or her vehicle on city business, for a cost of $10 per person. If the city drops this optional coverage, the employee still has the same total auto liability coverage limit available when using his or her auto on city business. The difference is that the employee's personal auto liability would respond first, and the LMCIT auto liability coverage would apply as excess.

RELEVANT LINKS:

IV. Bond coverage

LMCIT's bond coverage, which is an additional cost coverage option, is designed to meet the city's needs for bond coverage on public officials. If your city has LMCIT's bond coverage, it doesn't need to also purchase separate bonds to meet the statutory requirements for the city clerk and treasurer, the relief association treasurer, and so on.

LMCIT's bond coverage can also be used to meet the requirements for an Economic Development Authority (EDA) or port authority treasurer's bond. It also covers the gambling manager for relief associations that are operating charitable gambling.

V. All premiums

A. Retain more risk

LMC information memo, *LMCIT Workers' Compensation Coverage Guide*.

A surprising number of cities still have property/casualty deductibles as low as $250 or $500. For most cities, a deductible of at least $1,000, $2,500, or $5,000 will make more sense economically. Cities should consider the medical deductible options on workers' compensation as well. While there are obviously no guarantees, the premium savings *over time* should normally be more than enough to cover the additional risk the city is retaining. Of course, the city needs to make sure that reserve funds are available to cover a reasonable number of deductibles during the year.

For mid-sized and larger cities, an aggregate deductible approach often makes a lot of sense for the property/casualty coverage. Under this approach, the city retains a substantial deductible, but the city's maximum cost per year is capped at a specific dollar amount. For example, the city is responsible for the first $10,000 of each loss, but for no more than a maximum of $20,000 for the year. A much smaller "maintenance" deductible then applies to subsequent claims. This gives the city a way to reduce premiums significantly by retaining a substantial amount of risk, but the maximum amount of risk the city retains is a known amount that can be planned for and budgeted. The "retro-rating" option offers a similar alternative on workers' compensation, for cities with standard premiums of $25,000 or more.

RELEVANT LINKS:

LMC information memo, *Experience Rating in LMCIT's Liability and Workers' Compensation Premiums.*

B. Avoid losses

Premiums for municipal liability, auto liability, and workers' compensation are all experience-rated, so avoiding losses is a very effective way to reduce premiums. Employment liability and land use claims are weighted more heavily in the experience rating formula, so avoiding those types of claims provides an even greater payback. Remember the dividend formula is also loss-sensitive, so avoiding losses of all types also benefits the city when dividends are distributed.

LMC information memo, *The Agent's Role and Compensation in LMCIT.*

VI. Agent fees

Members of the LMCIT property/casualty program are required to designate an agent to provide various insurance and/or advisement services to the city. Cities participating in the workers' compensation program have the option not to use the services of an agent, although most do. When deciding on what amount to pay the agent, the city should remember that agent fees are negotiable and both parties are free to agree on a higher or lower percentage fee, or on a different basis for compensating the agent. Any increase or decrease in the agent's compensation will flow through directly as a dollar-for-dollar increase or decrease in the city's premium.

VII. Other possibilities but think carefully

A. Reduce coverage limits

One obvious idea for reducing premiums is to reduce coverage limits (e.g. dropping the optional excess liability coverage; reducing the bond limit; or reducing the liquor liability coverage limit for cities involved in beer or liquor sales). However, LMCIT urges cities to consider very carefully before taking any of these steps, and to look first at some of the other suggestions outlined previously in this memo.

Reducing coverage limits means the city is retaining the risk of the large loss that the higher limits would have covered. Financially it makes more sense to retain the risk of high-frequency, low-severity losses (i.e. use deductibles rather than gambling on the notion that a big loss won't occur and that you won't be faced with a catastrophic cost). Remember, large losses can and do occur, especially in the following situations.

First, one Minnesota city had a police liability claim that settled for $3 million; the statutory liability limits didn't apply because it was a federal civil rights claim. Besides civil rights claims, there are also several other types of claims that the statutory limits don't apply to.

RELEVANT LINKS:

Second, defense costs rather than damages are the biggest part of the cost under the land use coverage, and those costs can sometimes be very substantial. Keep in mind that the land use coverage limit is an annual aggregate limit; if you have one claim, you have less limits available for the second (or third or fourth) claim that year.

Third, the statutory liability limits probably don't apply to liability under the civil damages act for an illegal sale of liquor or beer, though there could possibly be room for some argument. For planning purposes, cities that are selling liquor or beer should not assume that there's any limit on their potential liability.

Fourth, employee dishonesty losses do happen and they can involve substantial amounts. They're not common, but city employee dishonesty losses in the $200,000 range aren't unheard of, even in small cities.

B. Eliminate volunteer accident coverage

LMC information memo, *LMCIT Workers' Compensation Coverage Guide*.

Another option the city could consider eliminating is the volunteer accident coverage. This optional coverage provides "no-fault" benefits to city volunteers who are injured while performing services for the city. However, quite a few cities are making more use of volunteers. For those city volunteers who aren't covered by workers' compensation, the volunteer accident coverage may be the only protection they have if they're injured while volunteering for the city.

VIII. Further assistance

LMCIT Underwriting
651,.281.1200
800.925.1122

The LMCIT underwriting staff is available to assist you with questions about reducing premium costs.