December 12, 2013

Acquisition of Commercial Insurance Coverages

The Office of the City Treasurer-Clerk's Risk Management section should consider revising its methods for acquiring commercial insurance coverages. Instead of using the "Defined Coverage Method" and "Appointment Method," consideration should be given to using the "Broker of Record Method" or an appropriately modified version of that method.

T. Bert Fletcher, CPA, CGMA
City Auditor

HIGHLIGHTS

Highlights of City Auditor Report #1404, a report to the City Commission and City management

WHY THIS AUDIT WAS CONDUCTED

The inquiry was conducted as directed by the City Commission to evaluate the effectiveness of the City's methods for acquiring commercial insurance coverages. Concerns were expressed that the methods currently and historically used do not provide sufficient competition among potential providers and, as a result, the City may be paying too much for the purchased coverages. To address those concerns we performed procedures to answer the following six questions:

1. What are the standard industry practices for selection of insurance brokers and carriers?
2. How many years has the City used the current insurance brokers and how much has the City paid those brokers during that period?
3. For each time the City acquired commercial insurance coverages, was a competitive process (e.g., Request for Proposals, or RFP) used; and when used, how many proposals/responses were received?
4. What methods are used by other governmental entities in their acquisition of commercial insurance coverages?
5. Is the City paying too much for its commercial insurance coverages because its acquisition methods do not provide for effective competition?
6. What can be done to improve the methods used by the City in the acquisition of commercial insurance coverages?

WHAT WE RECOMMENDED

The Office of the City Treasurer-Clerk's Risk Management section should consider revising its methods for acquiring commercial insurance coverages. Instead of using the "Defined Coverage Method" and "Appointment Method," consideration should be given to using the "Broker of Record Method" or a modified version of that method.

There is <u>no guarantee</u> that changing to another method will result in savings to the City. However, (1) the existence of a limited carrier market for many of the City's coverages, (2) the practices of other local governmental entities, and (3) the potential for reducing and better controlling broker fees/compensation all indicate that changing methods may be to the City's benefit.

To view the full report, go to:
http://www.talgov.com/auditing
For more information, contact us by e-mail at auditors@talgov.com or by telephone at 850/891-8397.

WHAT WE CONCLUDED

A summary of the answers to the six questions addressed in this audit is as follows:

1) Industry practices provide several methods to acquire commercial insurance coverages. Two of those methods require solicitation (requests) of competitive proposals from insurance brokers/carriers ("Defined Coverage Method" and "Broker of Record Method"). A third industry method ("Appointment Method") provides for appointment of a broker without competition, with the appointed broker being instructed to obtain proposals from insurance carriers. Under a fourth industry method ("Assignment of Market Method"), the insured entity selects more than one broker (competitively or non-competitively) and, for each selected broker, designates the specific insurance carriers from which the broker can solicit proposals.

2) Over the last ten years, the City has acquired the vast majority of its commercial insurance coverages through one broker, J. Smith Lanier & Co. and its predecessor companies. Premiums paid by the City for all commercial insurance coverages during the <u>last ten years</u> totaled \$35.6 million. The broker fees/compensation for the last ten years totaled approximately \$3.24 million, or 9.1% of the total premiums paid.

3) The City used the "Defined Coverage Method" (competitive selection) and the "Appointment Method" (noncompetitive selection) for acquiring insurance over the last ten years. Under the "Defined Coverage Method" the broker and carriers are selected as part of <u>one unified process</u>.

4) Our surveys of ten other local governments showed the "Broker of Record Method" was the only method used by those entities for acquiring commercial insurance coverages. Under that method, the broker is competitively selected (through a RFP process) <u>separate</u> from the acquisitions of the desired insurance coverages.

5) Broker fees/compensation paid by nine of the ten surveyed local governments, each using the "Broker of Record Method," averaged 5.11% of total premiums paid for purchased coverages. In comparison, broker fees/compensation payable by the City (under the "Defined Coverage Method" and "Appointment Method") for current year coverages represents 8.8% of total annual premiums. If the City paid 5.11% in broker fees/compensation, it would pay approximately \$150,000 less annually in broker fees/compensation.

6) Consideration should be given using the "Broker of Record Method" or a modified version of that method instead of the "Defined Coverage Method" and "Appointment Method."

We would like to express our appreciation for the assistance and cooperation provided during this inquiry by staff within the Risk Management section of the Office of the Treasurer-Clerk.

Office of the City Auditor

Inquiry into

CITY OF TALLAHASSEE
OFFICE OF THE CITY AUDITOR

T. Bert Fletcher, CPA, CGMA
City Auditor

Acquisition of Commercial Insurance Coverages

Report #1404 ***December 12, 2013***

Summary

The Office of the City Treasurer-Clerk's Risk Management section should consider revising its methods for acquiring commercial insurance coverages. Instead of using the "Defined Coverage Method" and "Appointment Method," consideration should be given to using the "Broker of Record Method" or an appropriately modified version of that method.

There is <u>no guarantee</u> that a change in methods will result in savings to the City. However, (1) the existence of a limited carrier (insurer) market for many of the City's coverages, (2) the practices of other local governmental entities, and (3) the potential for reducing and better controlling broker fees/compensation all indicate that changing methods may be to the City's benefit.

<u>INQUIRY OBJECTIVES</u>.

This inquiry was conducted as directed by the City Commission to evaluate the effectiveness of the City's methods for acquiring commercial insurance coverages. Concerns were expressed that the methods currently and historically used do not provide sufficient competition among potential providers (insurance brokers and carriers). As a result, concern was also expressed that the City may be paying too much for the purchased coverages.

To address those concerns, we performed procedures to answer the following six questions:

1. What are the standard industry practices for selection of insurance brokers and carriers?
2. How many years has the City used the current insurance brokers and how much has the City paid those brokers during that period?
3. For each time the City acquired commercial insurance coverages, was a competitive process (e.g., Request for Proposals, or RFP) used; and when used, how many proposals/responses were received?
4. What methods are used by other governmental entities in their acquisition of commercial insurance coverages?
5. Is the City paying too much for its commercial insurance coverages because its acquisition methods do not provide for effective competition?
6. What can be done to improve the methods used by the City in the acquisition of commercial insurance coverages?

<u>INQUIRY RESULTS</u>.

<u>Question No. 1</u>. Industry practices provide several methods that an entity (City) may use to acquire commercial insurance coverages. Two of those methods require solicitation (requests) of competitive proposals from insurance brokers/carriers ("Defined Coverage Method" and "Broker of Record Method"). A third industry method ("Appointment Method") provides for appointment of a broker without competition, with the appointed broker being instructed to obtain proposals from insurance carriers. Under a fourth industry method ("Assignment of Market Method"), the insured entity selects more than one broker (competitively or non-competitively) and, for each selected broker, designates the specific insurance carriers from which the broker can solicit proposals. A determination as to which method is most beneficial to an entity acquiring insurance coverages depends on various circumstances, such as how many carriers are willing to provide (and are capable of providing) the specific coverages and the nature of relationships between brokers and carriers.

Question No. 2. Over the last ten years, the City has acquired the vast majority of its commercial insurance coverages through one broker, J. Smith Lanier & Co. and its predecessor companies. Specifically, for the last ten years (and longer for some coverages) that broker has been used to acquire all coverages for eight of the nine categories of commercial insurance needed by the City. The coverages purchased solely through J. Smith Lanier & Co. (and the lengths of coverages) include:

- Commercial Property and Boiler and Machinery *(thirty-three years)*.
- Excess Workers' Compensation *(twenty years)*.
- Aviation Liability *(twenty years)*.
- Professional Liability for Emergency Medical Services *(since coverage determined necessary nine and one-half years ago)*.
- Property Insurance for the Renaissance Building. *(since coverage determined necessary seven and one-half years ago).*
- Fiduciary Liability for Pension Advisory Boards *(since coverage determined necessary ten years ago)*.
- Property Insurance for Fine Arts *(since coverage determined necessary two years ago)*.
- Property Insurance for the Neighborhood Stabilization Program *(since coverage determined necessary two years ago)*.

The remaining coverage, Police and Firefighter Statutory Death Benefits, was acquired by the City through two different brokers over the last 12 years; LB Bryan & Co. *(most recent six-year period)* and Hunt Insurance Co. *(previous six-year period)*.

Premiums paid by the City for all commercial insurance coverages during the <u>last ten years</u> totaled $35.6 million. Included as part of that premium total are broker fees/compensation (i.e., the broker retains a percentage of the premium for its services). The broker fees/compensation for the last ten years totaled approximately $3.24 million, or 9.1% of the total premiums paid. For the current policies in place, broker fees/compensation will total $357,196, or 8.8% of the $4,048,649 in annual premiums payable.

Question No. 3. As noted under Question No. 1, our review disclosed there are several methods used to obtain commercial insurance coverage. Our inquiry disclosed that the Office of the Treasurer-Clerk's Risk Management section has used two of those industry methods for acquiring commercial insurance coverages over the last ten years. Those methods are (1) the "Defined Coverage Method" and (2) the "Appointment Method." Both methods, as well as other industry methods, provide for insurance coverage to be obtained from insurance carriers through an insurance broker.

The "Defined Coverage Method" has been used most often and provides for a competitive selection and procurement of needed coverages. Under that method, the broker and carriers are selected as part of <u>one unified process</u>. Specifically, the entity to be insured (e.g., City) requests proposals for coverages when determinations are made that insurance coverages are needed. Interested brokers go to the insurance market and find and obtain commitments from carriers willing to underwrite those coverages. Those brokers that are successful in obtaining such commitments then submit a proposal to the City. The submitted proposals include a combination of brokerage services as well as specific insurance coverages from individual carriers. The insured entity then evaluates all proposals and selects the broker and carrier(s) with the most favorable proposal(s).

The "Defined Coverage Method" is generally most beneficial to an entity seeking insurance coverages in an environment where there are multiple insurance carriers (insurers) willing and capable of providing the desired coverages. This is because multiple brokers will likely be able to obtain commitments/quotes from a large population of carriers and, therefore, provide more options (proposals) for the entity to consider and evaluate.

However, in an environment where there is a relatively limited number of carriers willing and capable of underwriting the desired coverages, the "Defined Coverage Method" may not always result in the selection of a broker that provides coverages at the most favorable cost. For example, if a broker successfully obtains commitments from all insurance carriers willing and capable of providing the applicable coverages and, as a result, in effect "blocks the market," that broker likely will be the only broker capable of submitting a responsive proposal. In the event that broker charges higher fees/compensation than other brokers that were "blocked," the City may pay more in total for the coverages than it would otherwise have paid if another broker had been selected.

Evidence obtained during this inquiry indicates that there are a limited number of carriers for many of the coverages acquired by the City. This is attributable to the amount of coverage needed by the City. Specifically, for several coverages there are only a few carriers that have the resources and/or are willing to underwrite the relatively large risk (e.g., the City's property is valued in excess of $1 billion). The limited number of available carriers may have resulted in a blocking of the market. (Blocking the market does not infer or imply any inappropriate behavior or action by a broker; the market is, in essence, blocked because a broker has ongoing and positive relationships with the limited number of available insurance carriers.) These circumstances may have contributed to the limited number of proposals that have been submitted for the applicable coverages over the last ten years. More often than not, only one proposal (from the incumbent broker) was received for solicitations made by the City during that period.

In regard to the "Appointment Method," a broker is selected without competition. For all instances where this method has been used by the City, the incumbent (current) broker has been appointed. Because of the lack of competition, the City has not demonstrated that the best coverage was obtained at the most reasonable cost in most of those instances.

Question No. 4. In contrast to the two methods used by the City, our surveys of ten other local governments showed the "Broker of Record Method" was the only method used by those entities for acquiring commercial insurance coverages. Under that method, the broker is competitively selected (through a RFP process) separate from the acquisitions of the desired insurance coverages. Criteria used in the selection of brokers under this process generally include consideration of broker fees/compensation as well as the experience and ability to provide the needed brokerage services.

After a broker is selected under the "Broker of Record Method" and a contract is successfully negotiated and executed, the governmental entity instructs the broker to go to the applicable insurance market (property, liability, etc.) and obtain proposals from willing and capable carriers for specific coverages when determinations are made those coverages are needed. Those carrier proposals are obtained and presented to the governmental entity for evaluation and selection (generally in consultation with the broker).

Question No. 5. Compensation paid to brokers selected under the "Broker of Record

Method" is generally controlled by the governmental entity through contractual terms that pay the broker an annual flat fee for services and/or limit the amount of commission a broker can accept and retain from insurance carriers awarded the coverages. Controlling compensation in this manner helps to encourage objectivity by the broker when soliciting and obtaining carrier proposals on behalf of the governmental entity. For example, it controls a broker's incentive to solicit and recommend insurance carriers that will pay the highest commission to the broker, especially in an environment where no other brokers are soliciting carrier proposals on behalf of the governmental entity.

In insurance markets where there is a relatively large population of carriers willing and capable of providing needed coverages, the "Broker of Record Method" may not employ competition to the extent that competition would be achieved through the "Defined Coverage Method." This is because the selected broker under the "Broker of Record Method" may not have sufficient relationships with each available carrier. As a result, proposals may not be solicited on behalf of the City from all available carriers.

On the other hand, in insurance markets where there are a limited number of carriers willing and capable of providing needed coverages, the "Broker of Record Method" may be more competitive and beneficial for the governmental entity. Specifically, as also explained previously, this method will allow the governmental entity to select the "best" broker (based in part on fees) to obtain quotes from those relatively few carriers that are willing and capable of providing the needed coverages. (This is based on the premise that the willing and capable carriers will provide quotes to the selected broker.)

As stated above, evidence obtained during this inquiry indicates that there are a limited number of carriers available to provide many of the coverages needed by the City. Because of this apparent market limitation, use of the "Broker of Record Method" (or a modified version of that method) should be considered by the City.

Broker fees/compensation paid by nine of the ten surveyed local governments, each using the "Broker of Record Method," averaged 5.11% of total premiums paid for purchased coverages. In comparison, the broker fees/compensation for current City policies in place acquired under the "Defined Coverage Method" and "Appointment Method" represents 8.8% of total annual premiums. If the City paid 5.11% in broker fees/compensation, it would pay approximately $150,000 less annually in broker fees/compensation for current coverages.

RECOMMENDATION.

Question No. 6. The Office of the City Treasurer-Clerk's Risk Management section should consider revising its methods for acquiring commercial insurance coverages. Instead of using the "Defined Coverage Method" and "Appointment Method," consideration should be given to using the "Broker of Record Method" or a modified version of that method.

There is no guarantee that changing to another method will result in savings to the City. However, (1) the existence of a limited carrier market for many of the City's coverages, (2) the practices of other local governmental entities, and (3) the potential for reducing and better controlling broker fees/compensation all indicate that changing methods may be to the City's benefit.

We would like to express our appreciation for the assistance and cooperation provided during this inquiry by staff within the Risk Management section of the Office of the Treasurer-Clerk.

Scope, Objectives, and Methodology

The Office of the City Auditor is an independent appraisal activity within the City organization for the review of operations as a service to the City Commission and to management.

Accordingly, we periodically respond to requests from the City Commission to independently review processes and procedures relative to City programs, activities, and functions.

This inquiry was conducted as directed by the City Commission (Commission) to address the City's process for acquiring commercial insurance coverages. Those coverages are obtained to mitigate certain City risks relative to property loss and liability. Concerns were expressed by the Commission that the methods currently and historically used by the City to acquire commercial insurance coverage do not provide sufficient competition among potential providers (insurance brokers and carriers). As a result, concerns were expressed that the City may be paying too much for the purchased coverages.

To address those concerns, we performed procedures to answer the following six questions:

1. What are the standard industry practices for selection of insurance brokers and carriers?
2. How many years has the City used the current insurance brokers and how much has the City paid those brokers during that period?
3. For each time the City acquired commercial insurance coverages, was a competitive process (e.g., Request for Proposals, or RFP) used; and when used, how many proposals/responses were received?
4. What methods are used by other governmental entities in their acquisition of commercial insurance coverages?
5. Is the City paying too much for its commercial insurance coverages because its acquisition methods do not provide for effective competition?
6. What can be done to improve the methods used by the City in the acquisition of commercial insurance?

To answer those questions, we performed the following audit procedures:

- We identified laws, rules, policies, and procedures governing the City's acquisition of commercial insurance coverages.
- We reviewed available industry literature and met with knowledgeable City staff (Risk Management section within the Office of the Treasurer-Clerk) and industry professionals regarding the methods for acquisition of commercial insurance.
- We identified the types of commercial insurance coverage purchased by the City (exclusive of health insurance and other insurance coverages pertaining to employee benefits and performance bonds).
- We determined the amount of insurance premiums and broker fees/commissions paid by the City for commercial insurance coverages over the last decade.
- We identified the insurance brokers (and carriers) from whom the City acquired insurance coverages and how long those brokers have been used by the City.
- We identified the methods used by the City's Office of the Treasurer-Clerk, Risk Management section to acquire the commercial insurance coverages.
- We identified and evaluated the individual purchases of commercial insurance coverages by the City over the last decade.
- We surveyed ten other local government entities within the State of Florida to determine their methods for acquiring commercial insurance coverages.

Through completion of the described audit procedures, we developed a recommendation to be considered by management for enhancing and improving the City's method for acquiring commercial insurance coverages.

We conducted this inquiry in accordance with the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our inquiry audit objectives.

City Commercial Insurance Coverages

Overview. Insurance is a mechanism used by an entity to control and mitigate the risk of loss of property or loss resulting from liability for specific events or circumstances. An entity may be "self-insured" for part or all such risks and may purchase commercial insurance for those risks not covered through self-insurance.

Under the concept of self-insurance, an entity generally establishes a separate fund for the purpose of setting aside resources to pay claims (e.g., property or liability) as they occur. On the other hand, when acquiring commercial insurance an entity in essence pays a fee (insurance premium) to transfer that risk to a separate commercial entity. When events occur (losses), claims are filed with that commercial entity (insurer) to obtain funds to cover losses incurred by the insured entity as the result of the insured event.

The City of Tallahassee is self-insured for some risks and acquires commercial insurance for other risks. Specifically, the City maintains reserve funds to self-insure for:

- Workers' Compensation up to $1 million per event.
- General Liability (includes premises liability, operational liability, employment practice liability, police civil liability, etc.)
- Automobile Liability.

Commercial insurance coverage is obtained by the City to cover remaining risks, to include:

- Workers' Compensation for events in excess of $1 million.
- Property damage or loss.
- Airport Liability.
- Statutory Death Benefits for police and firefighters.
- Professional Liability for City personnel providing basic and advanced lifesaving services (e.g., firefighters and emergency medical technicians, or EMTs).
- Fiduciary Liability for City Pension Advisory Boards.

As stated previously, this audit only addressed the City's acquisition of commercial insurance coverages. The City's self-insurance programs were not included in the scope of this audit.

Governing Laws, Rules, Policies, and Procedures

City Commission Policy 242 and the City's Procurement Manual provide for competitive acquisition/procurement of goods (commodities) and services for which the cost is expected to exceed certain thresholds. Under the City's procedures, the specific competitive procurement method that should be used depends on the amount of the expected costs. For purchases where the expected costs are between $1,000 and $25,000, quotes should be obtained from at least three vendors. For purchases with expected costs greater than $25,000, written formal proposals/bids should be solicited by the City through either the "Request for Proposals (RFP)" process or the "Invitation for Bid (IFB)" process. The RFP process should be used for purchases where the selection of the vendor is dependent on factors in addition to costs/fees, such as experience and ability of the potential vendors to provide the desired services.

Pursuant to the noted City policy and procedures, all City acquisitions of insurance coverages addressed in this inquiry were in amounts that required application of one of the described competitive procurement methods.

Industry Methods for Selecting Brokers
(Question No. 1)

Brokers and Carriers. Under general industry practices, entities (including governments) purchase insurance coverages either directly from an insurance carrier that actually underwrites the risk or through an insurance broker that finds such carriers for the entity based on the needed coverages. For the commercial coverages acquired by the City, most entities typically use a broker.

Advantages of using a broker include:

- The broker generally has more expertise than the insured entity as to the markets providing needed coverages and as to appropriate terms and conditions when writing policies.
- The broker maintains ongoing relationships with individual carriers.
- The broker performs the actual search for and identification of available and willing carriers and interacts with those carriers on behalf of the City.

In summary, the broker has the industry expertise to help the City obtain the needed coverage at reasonable costs. Brokers are typically compensated for their services through (1) a direct fee paid by the insured entity (City) and/or (2) a commission paid by the insuring carrier, generally as a percentage of the annual insurance premium paid by the insured entity for the coverage.

In those instances where carriers are willing to bypass a broker and interact and deal directly with the insured entity, the entity should have the appropriate knowledge and expertise to ensure it obtains appropriate and adequate coverage at a reasonable cost. The Risk Management section within the Office of the Treasurer-Clerk has elected to use brokers when acquiring commercial insurance coverages.

There are several industry methods for acquiring insurance coverages through a broker. Those methods are described in the following paragraphs.

Appointment Method. This method provides for the outright selection and appointment of a broker by an entity without using a competitive selection process. *Advantages* of this process include possible establishment of a relationship between the broker and insured that allows the broker to obtain a thorough understanding of the insured entity's coverage needs and work efficiently on behalf of the insured entity. The *disadvantages* are that the insured entity may pay higher fees and commissions for the broker's services due to the lack of competition and, the use of the "Appointment Method" may restrict the insured entity's exposure to ideas and concepts from other brokers. In addition, this method is not in accordance with City policy and procedures that require solicitation for competitive proposals for acquisitions of goods and services for which the costs exceed certain thresholds.

Defined Coverage Method (or Unrestricted Competition Method). Under this method, the entity acquiring insurance defines the specific coverages needed and then solicits proposals (e.g., through the RFP process) from available brokers. Interested brokers go to the insurance market and, through existing or new relationships, find individual carriers willing to underwrite the defined coverages. The interested brokers that are successful in finding one or more carriers willing to underwrite the coverages then prepare and submit a proposal to the insured entity (City). The insured entity then evaluates and selects the broker with the best proposal(s). (In instances where the selected broker provides more than one possible carrier as part of their proposal, the entity also selects the most favorable and advantageous carrier proposal.)

The Defined Coverage Method is perceived as a competitive method for acquiring insurance coverages. That method is *most advantageous* when there is a relatively significant number of individual brokers and carriers in the market for the needed coverages, as the method provides the potential for proposals from multiple brokers and carriers.

Because under industry practices, as described by knowledgeable industry professionals interviewed during this audit, individual carriers only commit to a single broker for a given RFP, the Defined Coverage Method *may not be as effective* when there are a limited number of brokers and/or carriers in the market for the needed coverages. For example, if there are multiple brokers interested in providing a proposal in response to an entity's RFP, but there are only a relatively few number of carriers in the market for the needed coverages, those few carriers are likely to provide their commitments and quotes (proposed policies) to the broker with whom they have established the most positive relationship. Accordingly, the broker(s) with the best relationships with the available carriers often will be the only broker(s) capable of submitting a meaningful proposal to the entity. In the event the fees/commissions charged by that broker are higher than the fees/commissions charged by other interested brokers who were not successful in obtaining commitments and quotes from the available carriers, the insured entity may pay a higher fee for broker services. *(NOTE: The industry term "the market is blocked" is used to describe instances in which the available carriers are committed to only one broker.)*

Furthermore, under this method as implemented by the City, there is no contract executed between the broker and the City. The only contractual document resulting from this process is the formally executed insurance policy between the City and the selected carrier. Accordingly, the City has limited ability to control and govern broker fees and require full disclosure of all broker compensation. Instead, those fees and any other broker compensation are based on terms and conditions established by and between the selected broker and carrier(s).

<u>Broker of Record Method (or Broker's Proposal Method)</u>. Under this method, the insured entity requests brokers to provide proposed insurance programs separate from the acquisitions of specific insurance coverages. As an example, an entity may prepare and issue a RFP to available brokers, requesting the brokers to provide proposed methods and fees/costs for obtaining needed insurance coverages for the entity. The entity evaluates and selects the broker (or possibly multiple brokers) with the best proposal(s) and subsequently executes a contract for broker services. Criteria used to evaluate and select brokers often include experience and ability as well as fees and costs.

Under this method, the insured entity executes a contract for the agreed-upon broker services. After the contract for broker services has been executed, the insured entity typically requests the selected broker to periodically go to the insurance market and solicit proposals from carriers for needed coverages. The broker contacts the market and obtains quotes (proposed policies) from interested carriers. The broker typically assists the insured entity in evaluating and selecting the best carrier and policy from the submitted proposals. Insurance policies are then purchased from those "best" carriers/proposals.

The <u>*advantages*</u> of this acquisition method include: (1) the potential receipt of multiple proposals with a variety of ideas and program concepts, and (2) the ability to evaluate and compare broker fees as part of the selection process, separate from the evaluation and selection of carrier quotes. Also, because a written contract is executed between the broker and the insured entity, this method can be used to control and govern broker fees and compensation through specific contractual terms and conditions; and, provide an increased measure of objectivity and independence by the selected broker when soliciting and obtaining quotes from carriers, especially when the fees/compensation paid the broker are not dependent on commissions paid the broker by the carrier(s) awarded the coverages.

In regard to <u>*disadvantages*</u>, this method may not provide the same degree of competition in those instances where there is a large market (i.e., large population of willing and capable carriers) for the needed coverages. For example, the selected broker under the Broker of Record Method may not contact and obtain quotes from as many carriers as would be provided under the Defined Coverage Method, under which several responding brokers may provide quotes from multiple carriers. Accordingly, the Broker of Record Method may be more beneficial in those instances where there is a more limited market (i.e., relatively few carriers capable and willing to provide quotes/coverages).

Another *matter that should be considered under this method* is that, even when the insured entity controls the fees/compensation payable to the broker, the insured entity may have limited ability to control "other compensation" paid by the insurance carrier to the broker. Any "other compensation" paid by the carrier to the broker will likely be passed on to the insured entity through the carrier's premiums. Accordingly, insured entities using this method should take appropriate measures to ensure any "other compensation" is properly controlled (e.g., via contractual terms and conditions) and fully disclosed.

Qualified Competitive Quotes Method (or Assignment of Market Method). Under this method the insured entity designates for each selected broker the specific carriers from which that broker may obtain quotes for needed coverages. Specifically, an entity may instruct one broker to obtain quotes for a needed coverage from one set of specific carriers and designate another broker to obtain quotes for that same needed coverage from a different set of carriers.

Brokers used by the insured entity under this method could be appointed (see first method described in this section) or selected through separate competitive processes as described in the previously-described Broker of Record Method. The *advantages* and *disadvantages* of this method are the same as described for the two underlying methods. *One additional potential advantage* is this method may generate more competition by allowing additional carrier proposals in an environment where broker-carrier relationships are such that certain carriers are willing to provide proposals (quotes) only through a certain broker (i.e., in comparison to the "Broker of Record Method" where there is only one selected broker through which all interested carriers must submit their proposals).

Table 1 provides a summary of the different methods and their potential advantages and disadvantages.

Table 1
Industry Methods for Acquiring Insurance Coverages

	Method	Description	Potential Advantages	Potential Disadvantages
1	Appointment Method	Noncompetitive selection and appointment of a broker.	(1) Strong relationship between insured and broker allowing thorough understanding by broker of insured's needs.	(1) Higher broker fees and commissions. (2) Restricts insured's exposure to other ideas and concepts. (3) Lack of competition may violate intent of procurement laws, rules, and policies. (4) As implemented by the City, limits the ability to control broker fees and obtain full disclosure of any other broker compensation, as no broker contract is executed.
2	Defined Coverage Method	Competitive solicitation of proposals from brokers for specific coverages; whereby interested brokers obtain quotes from available carriers and submit a combined broker/carrier proposal for consideration and evaluation.	(1) May generate more competition from brokers in environment where there is a relatively <u>large</u> population of available carriers willing and capable of providing coverages. (2) Exposure to greater variety of ideas and concepts.	(1) May restrict competition from brokers in environments where there is a relatively <u>small</u> population of available carriers willing and capable of providing coverages. (2) As implemented by the City, limits the ability to control broker fees and obtain full disclosure of any other broker compensation, as no broker contract is executed.
3	Broker of Record Method	Competitive solicitation of proposals for brokerage services only; acquisition of specific coverages are done separately after a broker has been selected and broker contract executed.	(1) May generate more competition from brokers in environment where there is a relatively <u>small</u> population of available carriers willing and capable of providing coverages. (2) Exposure to greater variety of ideas and concepts. (3) Results in an executed broker contract which allows the insured to control broker fees and compensation.	(1) May restrict competition from brokers and carriers in environments where there is a relatively <u>large</u> population of available carriers willing and capable of providing coverages.
4	Assignment of Market Method	Insured entity designates specific market (or carriers) that each broker can approach for proposals. Brokers can be appointed or selected through the Broker of Record Method.	(1) Same as those shown above, depending on method used to select broker. (2) Allows insured entity to select and designate brokers based on broker's expertise and carrier relationships. (3) May generate more competition (through additional carrier proposals) in an environment where broker-carrier relationships are such that certain carriers are willing to provide their quotes only through a specific broker.	(1) Same as those shown above, depending on method used to select broker.
Source: Industry literature and discussions with knowledgeable industry professionals within and external to the City.				

History of City Acquisition of Commercial Insurance Coverages (Question No. 2)

To provide a history of the City's acquisition of commercial insurance coverages we examined activity over the last ten years (fall 2003 through fall 2013) to determine:

- Specific coverages purchased.
- Brokers through whom those purchases were made.
- Total amounts paid by the City for those coverages.
- Compensation paid to the applicable brokers for those coverages.

That information as determined through our inquiry procedures is disclosed in **Table 2** that follows.

Table 2
Commercial Insurance Coverages Acquired by the City During the Last Ten Years
(Note 1)

Type Coverage	Description	Brokers *(Note 2)*	Total Amount Paid	Estimated Broker Compensation *(Note 3)*
Commercial Property and Boiler and Machinery	Covers the City for damage or loss to City-owned improved properties (buildings, generating plants, substations, water tanks and wells, pump and lift stations, etc.) and contents (vehicles, furniture, computers, etc.) from accidents, storms, fire, theft, etc. The City is covered up to $700 million. *(Note 4)*	J. Smith Lanier & Co. and its predecessor companies for all ten years.	$30,640,553	$2,549,294
Excess Workers' Compensation	Covers the City in a major work event (accident where employees are hurt or injured) for which the required workers compensation payments would exceed $1 million (City is self-insured up to $1 million). There is no monetary cap on the amounts this policy would pay.	J. Smith Lanier & Co. and its predecessor companies for all ten years.	$2,264,266	$339,413
Aviation Liability	Covers the City's liability for bodily injury and property damage to third parties arising out of airport operations; as well as other unique liabilities arising from airport operations. Coverage caps vary by liability type but the cap for the primary coverage is $100 million per occurrence.	J. Smith Lanier & Co. and its predecessor companies for all ten years.	$1,066,747	$156,705
Police and Firefighter Statutory Death Benefits	Pursuant to State statutes the City must pay certain death benefits on behalf of police officers and firefighters killed in the line of duty. The City elected to cover the risk of such payments through commercial insurance rather than self-insurance.	(1) LB Bryan & Co. for last six years. (2) Hunt Insurance Group for the previous six years.	$157,687	$23,653
Professional Liability for Emergency Medical Services (EMS) provided by City personnel	Covers the City for medical malpractice and other liability resulting from basic and advanced life saving services provided by City emergency medical technicians (EMTs) and firefighters. Maximum coverage is $5 million annually.	J. Smith Lanier & Co. and its predecessor companies since City staff started providing advanced life saving services (nine and one-half years).	$850,922	$85,092
Property Insurance for the	Because this property is co-owned by the City and County, a separate property	J. Smith Lanier & Co. and its predecessor	$425,408	$62,322

Renaissance Building	insurance policy was required. This policy covers the City for damage or loss. Coverage is for $13 million.	companies since building completed and coverage required 2006 (seven and one-half years).		
Fiduciary Liability for City Pension Advisory Boards	Covers the City for fiduciary liability that results from the City's police, fire, and general employee pension advisory boards. Separate policies are purchased for each advisory board. (This table shows combined amounts for all three policies.) Maximum coverage is $1 million annually for each board.	J. Smith Lanier & Co. and its predecessor companies for all ten years.	$178,544	$26,425
Fine Arts	Covers the City for damage or loss to the "Refregier" mosaic panels donated to the City in 2011. Coverage limit is $120,000.	J. Smith Lanier & Co. and its predecessor companies since City determined coverage was needed after murals were obtained in 2011 (two years).	$6,108	$902
Neighborhood Stabilization Program (NSP) Property	Coverage for individual properties under the NSP, where the City acquires and rehabilitates houses for resale to eligible families. The City's Commercial Property and Boiler and Machinery Policy does not cover this risk due to the size of the deductibles established in that policy. Individual properties are insured for their values as they are acquired.	J. Smith Lanier & Co. and its predecessor companies since City determined coverage was needed in 2011 (two years).	$5,291	$489
TOTALS			**$35,595,526**	**$3,244,295**
Source: Auditor analysis of City records and information provided by brokers.				

Notes: (1) Coverages and costs for Police and Fire Statutory Death Benefits are for the last 12 years. Coverage for other categories is for the last 10 years or since the coverage was first purchased if less than 10 years.

(2) J. Smith Lanier & Co. was previously Wachovia Securities in 2006, and Palmer & Cay prior to 2006. The same broker team (individuals) worked with the City prior to, during, and after each of these changes.

(3) Broker compensation was estimated using current commission rates. Risk Management staff indicated those rates likely would not have significantly changed throughout the last 10 years.

(4) This includes two separate builders risk policies acquired during construction (additions/renovations) of the Hopkins Unit 2 Repowering Unit and Thomas P. Smith Advanced Wastewater Treatment Facility. Coverage was established based on the construction schedules and values of construction-in-progress.

As shown by **Table 2** above, the City has used a single broker for all but one of the purchased coverages for the last ten years. Specifically, for the last ten years J. Smith Lanier & Co. (includes its predecessor companies) was the only broker through which insurance was acquired, other than coverage for police and firefighter statutory benefits. To provide additional perspective on the City's use of brokers, we determined how long each broker has been used in the provision of the different coverages. **Table 3** that follows shows the result of that analysis.

Table 3
Length of Coverages by Current Brokers
(By Coverage Type)

Type Coverage	Current Broker	Length of Coverage *(Note 1)*	Period of Coverage
Commercial Property and Boiler and Machinery	J. Smith Lanier & Co. and its predecessor companies *(Previous broker unknown)*	Approximately 33 years	Approximately 1980 to the present
Excess Workers' Compensation	J. Smith Lanier & Co. and its predecessor companies *(Previous coverage was through the Florida League of Cities Insurance Trust)*	Approximately 20 years	1993 to the present
Aviation Liability	J. Smith Lanier & Co. and its predecessor companies *(Previous broker unknown)*	Approximately 20 years	Early 1990s to the present
Police and Firefighter Statutory Benefits	LB Bryan & Co. *(Previous broker was Hunt Insurance Co.)*	Approximately 6 years	October 2007 to the present
Professional Liability for Emergency Medical Services (EMS) provided by City personnel	J. Smith Lanier & Co. and its predecessor companies *(No previous broker as coverage not acquired previously)*	Approximately 9.5 years	Since early 2004
Property Insurance for the Renaissance Building	J. Smith Lanier & Co. and its predecessor companies *(No previous broker as coverage not acquired previously)*	Approximately 7.5 years	March 2006 to the present (after completion of the Renaissance Building and subsequent City-County agreement)
Fiduciary Liability for City Pension Advisory Boards	J. Smith Lanier & Co. and its predecessor companies *(No previous broker as coverage not acquired previously)*	Approximately 7 years for General Employees coverage Approximately 10 years for Police and Fire coverages	July 2006 to the present for General Employees August 2003 to the present for Police and Fire coverages
Fine Arts	J. Smith Lanier & Co. and its predecessor companies *(No previous broker as coverage not acquired previously)*	Approximately 2 years	July 2011 to the present (since City received the fine art)
Neighborhood Stabilization Program (NSP) Property	J. Smith Lanier & Co. and its predecessor companies *(No previous broker as coverage not acquired previously)*	Approximately 2 years	May 2011 to the present (coverage provided as needed)

Source: Auditor analysis of City records and information provided by knowledgeable City Risk Management staff.

Note 1: While this table shows that some of the coverages extended beyond the most recent ten-year period, our analysis of the applicable insurance market environment and circumstances only addressed the most recent ten-year period. Accordingly, audit conclusions derived through this inquiry should not be interpreted to be applicable to preceding periods.

Summary. For an extended period, the City has used a single broker, J. Smith Lanier & Co., for the vast majority of its coverages. Specifically, that broker is used for all coverages except for one (Statutory Death Benefits for Police and Firefighters).

Premiums paid for the commercial insurance coverages acquired by the City over the last ten years totaled $35.6 million. The broker compensation for those coverages during that period totaled $3.24 million, approximately 9.1% of total costs (premiums). (Note: The commissions were paid by carriers to the broker and included in the total premium paid by the City.)

(NOTE: <u>While Table 3 shows that some of the coverages extended beyond the most recent ten-year period, our analysis of the applicable insurance market environment and circumstances only addressed the most recent ten-year period. Accordingly, audit conclusions derived through this inquiry should not be interpreted to be applicable to those preceding periods.)</u>

Methods Used by the City To Acquire Commercial Insurance (Question No. 3)

In connection with our analysis of City acquisitions of commercial insurance coverages over the last ten years, we determined and evaluated the specific acquisition methods used by the City. Our analysis showed for the three largest acquisitions (commercial property and boiler and machinery, excess workers' compensation, and airport liability), the City generally used the "<u>Defined Coverage Method</u>" whereby a RFP was periodically (e.g., every three years) prepared and issued by the City to brokers, requesting interested brokers to individually solicit carrier quotes and provide proposals for underwriting the desired coverages. This process was also used in the City's acquisition of coverage for police and firefighters statutory death benefits.

For each of the remaining acquisitions of commercial insurance coverages over the last ten years, we found the City used the "<u>Appointment Method</u>" whereby the City made an outright selection and appointment of a broker without using a competitive selection process. In those instances the appointed broker was the incumbent broker (J. Smith Lanier & Co. for the vast majority of the coverages).

Tables 4 through 8 that follow show the purchased coverages and related methods of acquisition.

Table 4
Acquisitions of Insurance Coverages for the Past Ten Years
COMMERCIAL PROPERTY AND BOILER AND MACHINERY

	Acquisition Year	Acquisition Method	Period of Coverage	Number of Brokers Providing Proposals	Carriers included in Brokers' Proposals	Broker Selected to Provide Coverage	Records Support "Best" Proposal Selected by City?
1	2001	Emergency Purchase *(Note: Commercial Property and Boiler and Machinery coverage was acquired under "Emergency Procurement Provisions" due to the terrorism event of 9-11-2001.)*	Oct. 2001 through March 2005	Not Applicable	One set of 6 carriers *(Note 1)*	Palmer & Cay (predecessor company to J. Smith Lanier & Co.)	Not Applicable
2	2005	Defined Coverage Method Request for Proposals	April 2005 through March 2008	2 (Palmer & Cay and Arthur J. Gallagher)	Palmer & Cay – one set of 6 carriers *(Note 1)* Arthur J. Gallagher – one set of 3 carriers	Palmer & Cay (predecessor company to J. Smith Lanier & Co.)	YES

3	2008	Appointment Method	April 2008 through March 2009	Not Applicable	Not Applicable	J. Smith Lanier & Co.	Not Applicable
4	2009	Defined Coverage Method Request for Proposals	April 2009 through March 2012	1 (J. Smith Lanier)	One set of 9 carriers *(Note 1)*	J. Smith Lanier & Co.	Not Applicable
5	2012	Defined Coverage Method Request for Proposals	April 2012 through March 2017	1 (J. Smith Lanier)	One set of 8 carriers *(Note 1)*	J. Smith Lanier & Co.	Not Applicable
Source: Auditor analysis of City records and information provided by knowledgeable City Risk Management staff.							

Note: (1) Each carrier within the set was selected and participated in the total coverage.

As shown above in **Table 4**, the "Defined Coverage Method" was used three times over the last ten years to obtain coverage for Commercial Property and Boiler and Machinery. For the most recent two of those three acquisitions, only one broker provided a proposal. That broker is the current broker, J. Smith Lanier & Co. For each of the three acquisitions involving the "Defined Coverage Method," documentation from applicable agenda items and internal communications among City Risk Management staff indicated the existence of a limited market, meaning there were relatively few carriers willing and capable of underwriting the coverages needed by the City. Explanations provided by City staff and industry professionals indicate this is attributable to the relatively large risk exposure of the City as its power plants, general government buildings, and other insurable infrastructure are currently valued in amounts exceeding $1 billion. Because of the limited market (limited number of carriers available to underwrite the risk), the broker successful in obtaining quotes from available carriers will likely be the incumbent broker that already has established relationships with those carriers. One broker that corresponded with the City, but did not submit a proposal, indicated that, because the broker submitting the sole proposal had the "market locked up," it was not feasible for other brokers to also submit reasonable proposals.

Table 4 also shows that for one year (April 2008 through March 2009), the City did not use competitive methods to provide the coverage. For that year the City renewed its coverage with the current broker, J. Smith Lanier & Co., through the "Appointment Method." Discussions with City Treasurer-Clerk's Risk Management staff indicated the current broker and carriers were "reappointed" for that year as the repowering project at the Hopkins electric generating plant was underway, and completion was expected to extend beyond the expiration date of the current insurance coverage (April 1, 2008). To insure that project during construction, the City added a "builder's risk coverage" to the existing property policy through the existing broker/carriers. Based on meetings with the carriers and loss prevention engineers, risk management staff determined that remarketing the insurance coverage while that project was under construction was not advisable. Accordingly, remarketing of the coverage (through the "Defined Coverage Method") was intentionally deferred for one year.

Table 5
Acquisitions of Insurance Coverages for the Past Ten Years
EXCESS WORKERS' COMPENSATION

	Acquisition Year	Acquisition Method	Period of Coverage	Number of Brokers Providing Proposals	Number of Carriers included in Brokers' Proposals	Broker/Carriers Selected to Provide Coverage	Records Support "Best" Broker and/or Carrier Proposal Selected by City?
1	2001	Defined Coverage Method Request for Proposals	Oct. 2001 through Sept. 2004	1 Palmer & Cay (predecessor company to J. Smith Lanier & Co.)	2	Broker: Palmer & Cay (predecessor company to J. Smith Lanier & Co.) Carrier: AIG	YES
2	2004	Defined Coverage Method Request for Proposals	Oct. 2004 through Sept. 2007	1 Palmer & Cay (predecessor company to J. Smith Lanier & Co.)	3	Broker: Palmer & Cay (predecessor company to J. Smith Lanier & Co.) Carrier: AIG	YES
3	2007	Defined Coverage Method Request for Proposals	Oct. 2007 through Sept. 2010	2 (J. Smith Lanier & Co. and Arthur J. Gallagher) *(NOTE 1)*	J. Smith Lanier & Co. – 4 Arthur J. Gallagher – 1 *(NOTE 1)*	Broker: J. Smith Lanier & Co. Carrier: AIG	YES
4	2010	Appointment Method	Oct. 2010 through Sept. 2013	Not Applicable	Not Applicable	Broker: J. Smith Lanier & Co. Carrier: Midwest	Not Applicable
5	2013	Defined Coverage Method Request for Proposals	Oct. 2013 through Sept. 2014 (One year only as directed by the City Commission)	1 (J. Smith Lanier & Co.)	2	Broker: J. Smith Lanier & Co. Carrier: Midwest	YES
Source: Auditor analysis of City records and information provided by knowledgeable City Risk Management staff.							

Note: (1) Arthur J. Gallagher submitted a proposal without a commitment from its proposed carrier. That carrier had previously committed to the other proposing broker, J. Smith Lanier & Co.

Similar to the purchases of Commercial Property and Boiler and Machinery, **Table 5** shows the "Defined Coverage Method" was the primary method used by the City over the last ten years for acquiring Excess Workers' Compensation coverage. Again, there was documentation and explanations indicating that the number of carriers willing and capable of providing the needed coverage was limited, and that the incumbent broker obtained commitments from those carriers that were willing and capable of providing the coverages.

For one three-year period the City did not use competitive methods to provide the coverage. For that period the City renewed its coverage with the incumbent broker, J. Smith Lanier & Co., through the "Appointment Method." There was no evidence this renewal and method was submitted to the City Commission for authorization.

Table 6
Acquisitions of Insurance Coverages for the Past Ten Years
AVIATION LIABILITY

	Acquisition Year	Acquisition Method	Period of Coverage	Number of Brokers Providing Proposals	Number of Carriers included in Brokers' Proposals	Broker/Carriers Selected to Provide Coverage	Records Support "Best" Broker and/or Carrier Proposal Selected by City?
1	2000	Defined Coverage Method Invitation For Bids (IFB) *(Subsequent to this year the RFP process was used to solicit proposals for this coverage.)*	Oct. 2000 through Sept. 2003	3 (Palmer & Cay; Hunt Insurance Co., and Arthur J. Gallagher)	Palmer & Cay – one set of two carriers sharing in the coverage Hunt Insurance Co. - 1 Arthur J. Gallagher – 1	Broker: Palmer & Cay (predecessor company to J. Smith Lanier & Co.) Carriers: Old Republic Insurance Co. and Lloyds of London (shared in coverage)	YES (Based on limited records that were available)
2	2003	Appointment Method	Oct. 2003 through Sept. 2004	Not Applicable	Not Applicable	Broker: Palmer & Cay (predecessor company to J. Smith Lanier & Co.) Carriers: Old Republic Insurance Co. and Lloyds of London (shared in coverage)	Not Applicable
3	2004	Defined Coverage Method Request for Proposals	Oct. 2004 through Sept. 2007	1 Palmer & Cay (predecessor company to J. Smith Lanier & Co.)	3	Broker: Palmer & Cay (predecessor company to J. Smith Lanier & Co.) Carriers: Old Republic Insurance Co. and Lloyds of London (shared in coverage)	YES
4	2007	Defined Coverage Method Request for Proposals	Oct. 2007 through Sept. 2010	2 (J. Smith Lanier & Co. and	J. Smith Lanier & Co. – 2	Broker: J. Smith Lanier & Co.	YES

				Arthur J. Gallagher) *(NOTE 1)*	Arthur J. Gallagher – 1 *(NOTE 1)*	Carriers: Old Republic Insurance Co. and Lloyds of London (shared in coverage)	
5	2010	Appointment Method	Oct. 2010 through Sept. 2013	Not Applicable	Not Applicable	Broker: J. Smith Lanier & Co. Carrier: Initially Old Republic Insurance Co.; subsequently changed to ACE Property & Casualty Co.	Not Applicable
6	2013	Defined Coverage Method Request for Proposals	Oct. 2013 through Sept. 2014 (One year only as directed by the City Commission)	1 (J. Smith Lanier & Co.)	2	Broker: J. Smith Lanier & Co. Carrier: ACE Property & Casualty Co.	YES
Source: Auditor analysis of City records and information provided by knowledgeable City Risk Management staff.							

Note: (1) Arthur J. Gallagher submitted a proposal without a commitment from its proposed carrier. That carrier had previously committed to the other proposing broker, J. Smith Lanier & Co.

Similar to **Table 4** and **Table 5, Table 6** above shows the "Defined Coverage Method" was the primary method used by the City over the last ten years for acquiring Aviation Liability coverage. However, for one annual period and a subsequent three-year period, the City used the "Appointment Method" to obtain coverage. There was no evidence the renewals through the "Appointment Method" were submitted to the City Commission for authorization.

While different carriers were used, the coverage was obtained through the same broker for the entire period, regardless of the method of acquisition. Documentation and explanations were also provided indicating there were also a limited number of carriers in the market that were willing and capable of providing Aviation Liability coverage for the City.

Table 7
Acquisitions of Insurance Coverages for the Past Ten Years
STATUTORY DEATH BENEFITS FOR POLICE AND FIREFIGHTERS

	Acquisition Year	Acquisition Method	Period of Coverage	Number of Brokers Providing Proposals	Number of Carriers included in Brokers' Proposals	Broker/Carriers Selected to Provide Coverage	Records Support "Best" Broker and/or Carrier Proposal Selected by City?
1	2001	Defined Coverage Method Request for Proposals	Oct. 2001 through Sept. 2004	2 (Palmer & Cay and Hunt Insurance Co.)	Palmer & Cay (predecessor company to J. Smith Lanier & Co.) – 1 Hunt Insurance Co. - 1	Broker: Hunt Insurance Co. Carrier: AIG	YES
2	2004	Defined Coverage Method Request for Proposals	Oct. 2004 through Sept. 2007	1 (Hunt Insurance Co.)	2	Broker: Hunt Insurance Co. Carrier: AIG	YES
3	2007	Defined Coverage Method Request for Proposals	Oct. 2007 through Sept. 2010	3 Hunt Insurance Co; LB Bryan & Co., and Arthur J. Gallagher) *(NOTE 1)*	Hunt Insurance Co. – 1 LB Bryan & Co. – 2 Arthur J. Gallagher - 1 *(NOTE 1)*	Broker: LB Bryan & Co. Carrier: Chubb (Federal Insurance Co.)	YES
4	2010	Appointment Method	Oct. 2010 through Sept. 2013	Not Applicable	Not Applicable	Broker: LB Bryan & Co. Carrier: Chubb (Federal Insurance Co.)	Not Applicable
5	2013	Defined Coverage Method Request for Proposals	Oct. 2013 through Sept. 2014 (One year only as directed by the City Commission)	1 (LB Bryan & Co.)	2	Broker: LB Bryan & Co. Carrier: AIG	YES
Source: Auditor analysis of City records and information provided by knowledgeable City Risk Management staff.							

Note: (1) Arthur J. Gallagher submitted a proposal without a commitment from its proposed carrier.

For acquisitions of coverage for Statutory Death Benefits for Police and Fire, **Table 7** shows the "Defined Coverage Method" was the primary method used by the City over the last ten years. However, for one three-year period the City used the "Appointment Method" to obtain coverage. There was no evidence the renewal through the "Appointment Method" was submitted to the City Commission for authorization.

Table 8
Acquisitions of Insurance Coverages for the Past Ten Years
"OTHER COVERAGES"

	Coverage	Acquisition Method	Period Over Which Coverage Has Been Purchased	Broker	Current Carrier	Current Annual Premium
1	Professional Liability for Emergency Medical Services (EMS) provided by City personnel	Appointment Method	Last 9 and one-half years	J. Smith Lanier & Co.	James River Insurance Co.	$62,562
2	Property Insurance for the Renaissance Building	Appointment Method	Last 7 and one-half years	J. Smith Lanier & Co.	Zurich American Insurance Co.	$46,071
3	Fiduciary Liability for City Pension Advisory Boards	Appointment Method	Last 10 years	J. Smith Lanier & Co.	Travelers Casualty & Surety Co.	$21,927
4	Fine Arts	Appointment Method	Last 2 years	J. Smith Lanier & Co.	Travelers Property Casualty Co.	$2,042
5	Neighborhood Stabilization Program (NSP) Property	Appointment Method	Last 2 and one-third years	J. Smith Lanier & Co.	Lloyd's of London	$1,436
Source: Auditor analysis of City records and information provided by knowledgeable City Risk Management staff.						

Pursuant to City policies and procedures, each of the acquisitions for the "other coverages" shown in **Table 8** was in an amount that required competitive procurement methods. Although the "appointed" broker may have solicited quotes from available carriers for the coverages on behalf of the City, it is not apparent that appointment of a broker without competition met the intent of those City policies and procedures. Without competitive selection, the City did not adequately determine and demonstrate whether other brokers could have provided the same coverages at a lower cost.

Summary. Over the last 10 to 12 years, the City has purchased its commercial insurance coverages through either the "Defined Coverage Method" or the "Appointment Method." Documentation and evidence indicate that because of the limited market whereby there are only a relatively few number of carriers willing and capable of providing the needed coverages, the "Defined Coverage Method" has generally yielded only one (occasionally two) responsive broker proposal. The result has been applicable coverages have been acquired through the same broker year after year.

Furthermore, those acquisitions made through the "Appointment Method" have also resulted in the City continuing to purchase coverages through the incumbent broker, as the City has continuously appointed the incumbent broker to provide the coverages. By using the "Appointment Method" for those coverage acquisitions, the City has not, in most instances, demonstrated that the best coverage at the most reasonable price (cost) was obtained.

In response to the instances where the "Appointment Method" was used for certain acquisitions shown in **Table 8**, the Risk Management section indicated that the lack of timely communications from applicable City departments requesting updated or new coverages may have contributed to non-competitive purchases when the initial coverages were acquired; however, the Risk Management section acknowledged that competitive processes should have been used for subsequent acquisition of those coverages.

Methods Used by Other Local Governments To Acquire Commercial Insurance
(Question No. 4)

As part of our inquiry we surveyed ten other local government entities within the State of Florida to ascertain their methods for acquiring commercial insurance coverages. The surveyed entities, their methods of acquisition and methods of compensating brokers, and examples of insurance coverages acquired by those entities are shown in **Table 9** below.

Table 9
Survey of Ten Other Local Governments
Methods of Acquiring Commercial Insurance Coverages

	Local Government	Acquisition Method	Method of Compensating Broker	Examples of Coverages Types
1	City of Gainesville	Broker of Record	Flat Annual Fee	Excess Workers' Compensation Property Insurance Statutory Death Benefits for Police and Fire Fine Arts
2	City of Jacksonville	Broker of Record	Flat Annual Fee for some coverages Cap on Commissions received from carriers on other coverages	Excess Workers' Compensation Property Insurance
3	Gainesville Alachua County Regional Airport Authority	Broker of Record	Information Not Provided	Aviation Liability Property Insurance
4	City of Lakeland	Broker of Record	Cap on Commission received from carriers	Excess Workers' Compensation Property Insurance Aviation Liability
5	City of Ocala	Broker of Record	Flat Annual Fee	Excess Workers' Compensation Property Insurance
6	Hillsborough County Aviation Authority	Broker of Record	Flat Annual Fee	Excess Workers' Compensation Property Insurance Aviation Liability
7	Leon County District School Board	Broker of Record	Flat Annual Fee	Excess Workers' Compensation Property Insurance General Liability
8	Greater Orlando Aviation Authority	Broker of Record	Flat Annual Fee	Workers' Compensation Property Insurance Aviation Liability
9	Leon County	Broker of Record	Flat Annual Fee	Property Insurance General Liability
10	City of Pensacola	Broker of Record	Cap on Commission received from carriers	Excess Workers' Compensation Property Insurance

Source: Surveys of listed local governments.

As shown in **Table 9**, each of the surveyed local governments (municipalities, counties, authorities) use the "Broker of Record Method" (also known as the "Broker's Proposal Method"). Under that method, the broker is competitively selected (through a RFP process) separate from the actual acquisition of the desired insurance coverages. Specifically, after the broker has been selected, the insured entity periodically instructs the broker to go to the applicable insurance market and obtain proposals from willing and capable carriers for needed coverages. Those proposals are obtained and presented by the broker to the insured entity for evaluation and selection (likely in consultation with the broker).

In regard to selection of the brokers, several of the surveyed entities indicated costs/fees as well as other factors, such as experience and ability to render brokerage services, were used as evaluation criteria.

To control broker fees/costs, the surveyed entities generally paid a flat annual fee to the broker and/or placed restrictions (cap) on commissions the broker could receive from the carriers with whom the insurance was placed. Those restrictions, as explained by staff of the surveyed entities, included:

- Precluding the broker from accepting any commissions from carriers.
- Placing a cap on the amount of commissions the broker could accept from carriers.
- Requiring the broker to disclose any commissions accepted from carriers and to credit the flat fee for any such commissions received.
- Requiring the broker to provide additional services to the entity in the value of the amount of any commissions accepted from carriers.

Based on our survey, total annual fees/compensation paid by nine of the ten surveyed entities represented 5.11% of total premiums paid by those nine entities for the purchased insurance coverages. (One surveyed entity did not provide relevant information.)

Staff in some of the surveyed entities indicated during our discussions that the "Broker of Record Method" was more appropriate for their entities than the "Defined Coverage Method" for the following reason. In a market where there are a limited number of carriers willing and capable of providing the needed coverages, separating the selection of a broker from the specific acquisitions of insurance coverages allowed them to better control broker fees and costs. Specifically, that process allowed them to select a broker that charged the most reasonable costs/fees and to control (limit/disallow) any commissions received by the broker. *(Theoretically, in a limited market where there are few carriers willing or able to provide the needed coverages, the broker with the most favorable relationship with those few carriers will obtain their quotes for the coverages. Industry practices do not allow those carriers to also provide quotes for the same coverages through other brokers. Accordingly, in those instances where the broker that successfully obtains quotes and commitments from the few available carriers is <u>not</u> the broker that would charge the most reasonable fee or commission, the purchasing entity {e.g., City} may pay more for those services.)*

Other pertinent comments provided by staff of surveyed entities included:

- The markets for the desired coverages (property and liability) in Florida is limited to a relatively few carriers.
- Under the "Defined Coverage Method," the incumbent broker often will have an advantage in regard to subsequent acquisitions as the broker may have the available carriers committed in an ongoing relationship (have "the market locked up").
- Consultants can help develop an RFP for selecting a broker through the "Broker of Record Method" and also help in the evaluation of received proposals.
- Under the "Broker of Record Method," premiums paid by the insured entity should be monitored carefully to ensure the selected

broker is providing "lower premiums" when commissions are limited or disallowed (i.e., as commissions are often built into the premiums by the carriers).

- When selecting a broker, criteria other than fees/cost are important, such as ability and experience.

Summary. Unlike the City of Tallahassee, each of the surveyed entities used the "Broker of Record Method" for acquiring commercial insurance coverages. Those surveyed entities indicated the ability to control broker fees/compensation was a significant advantage in using that method.

Cost Comparison of Surveyed Entities to City of Tallahassee (Question No. 5)

In comparison to the surveyed entities addressed in the previous report section, the City of Tallahassee primarily used the "Defined Coverage Method" for acquiring commercial insurance coverages as explained in prior sections of this report. As previously described, brokers and insurance coverages are acquired simultaneously under that method. Specifically, for the needed coverages the City requests interested brokers to submit competitive proposals. Each broker wanting to participate goes to the applicable insurance market and obtains commitments and quotes (policy proposals) from individual carriers willing to underwrite the coverages through the broker. The City evaluates and selects the best proposal after considering costs/fees and other criteria such as experience and ability of the broker. Under this process, the City of Tallahassee does not pay a fee directly to the broker. Instead, the broker is compensated through a commission paid by the selected carriers providing the coverages. The commission is included in the premium paid by the City (i.e., part of the premium paid by the City is retained by the broker for the "market and placement" services provided by the broker).

Commissions payable by the City of Tallahassee for commercial insurance coverages acquired for the current year total $357,196, which is 8.8% of the total annual premiums in the amount of $4,048,649. Of the nine surveyed entities providing relevant information, only one paid a higher percentage of their premiums in broker fees (9.5%). For the other eight surveyed entities, the percentage of broker fees/compensation to total premiums ranged from 3.1% to 6.3%. As noted previously, the average for all nine surveyed entities that provided relevant information was 5.11%. If the City paid 5.11% in broker fees/compensation, it would pay approximately $150,000 less in brokerage fees for the current year.

Summary. The method used by the City of Tallahassee for acquiring commercial insurance coverages is not the method used by other local governments in the State of Florida. Broker fees paid by the City of Tallahassee are generally higher than broker fees/compensation paid by the surveyed entities.

Conclusion

Over the last ten years, the City acquired the vast majority of commercial insurance coverages through one broker, J. Smith Lanier & Co. and its predecessor companies. Specifically, for the last ten years (and longer for some coverages) that broker has been used to acquire all coverages for eight of the nine categories of commercial insurance needed by the City. The coverages purchased solely through J. Smith Lanier & Co. over the last ten years include:

- Commercial Property and Boiler and Machinery.
- Excess Workers' Compensation.
- Aviation Liability.
- Professional Liability for Emergency Medical Services.
- Property Insurance for the Renaissance Building.

- Fiduciary Liability for Pension Advisory Boards.
- Property Insurance for Fine Arts.
- Property Insurance for the Neighborhood Stabilization Program.

The remaining coverage, Police and Firefighter Statutory Death Benefits, was acquired by the City through two different brokers over the last 12 years; LB Bryan & Co. and Hunt Insurance Co.

Premiums paid by the City for all commercial insurance coverages during the last ten years totaled $35.6 million. Included as part of that premium total are broker fees/compensation (i.e., broker retains a percentage of the premium for its services). The broker fees/compensation for the last ten years totaled approximately $3.24 million, or 9.1% of total premiums paid. For the current year, broker fees/compensation are $357,196, or 8.8% of the $4,048,649 in premiums payable for that year.

The Office of the Treasurer-Clerk's Risk Management section used two industry methods for acquiring commercial insurance coverages over the last ten years. Those methods are (1) the "Defined Coverage Method" and (2) the "Appointment Method." Both methods, as well as other industry methods, provide for the insurance to be obtained from insurance carriers through an insurance broker.

The "Defined Coverage Method" has been used most often and provides for a competitive selection and procurement of needed coverages. Under that method, the broker and carriers are selected as part of one unified process. Specifically, the entity to be insured (e.g., City) requests proposals for coverages when determinations are made that insurance coverages are needed. Interested brokers go to the insurance market and find and obtain commitments from carriers willing to underwrite those coverages. Those brokers that are successful in obtaining such commitments then submit a proposal to the City. The submitted proposals include a combination of brokerage services as well as specific insurance coverages from individual carriers. The insured entity then evaluates all proposals and selects the broker and carrier(s) with the most favorable proposal(s).

The "Defined Coverage Method" is generally most beneficial to an entity seeking insurance coverages in an environment where there are multiple insurance carriers (insurers) willing and capable of providing the desired coverages. This is because multiple brokers will likely be able to obtain commitments/quotes from a large population of carriers and, therefore, provide more options (proposals) for the entity to consider and evaluate.

However, in an environment where there is a relatively limited number of carriers willing and capable of underwriting the desired coverages, the "Defined Coverage Method" may not always result in the selection of a broker that provides coverages at the most favorable cost. For example, if a broker successfully obtains commitments from all insurance carriers willing and capable of providing the applicable coverages and, as a result, in effect "blocks the market," that broker likely will be the only broker capable of submitting a responsive proposal. In the event that broker charges higher fees/compensation than other brokers that were "blocked," the City may pay more in total for the coverages than it would otherwise have paid if another broker had been selected.

Evidence obtained during this inquiry indicates that there are a limited number of carriers for many of the coverages acquired by the City. This is attributable to the amount of coverage needed by the City. Specifically, for several coverages there are only a few carriers that have the resources and/or are willing to underwrite the relatively large risk (e.g., the City's property is valued in excess of $1 billion). The limited number of available carriers may have resulted in a blocking of the market. (Blocking the market does not infer or imply any inappropriate behavior or action by the incumbent broker; the market was, in essence, blocked because a broker has ongoing and positive relationships with the limited number of available insurance carriers.) These circumstances may have contributed to the limited number of proposals that have been submitted for the applicable coverages over the last ten years. More often than not, only one proposal (from the incumbent broker) was received for solicitations made by the City during that period.

In regard to the "Appointment Method," a broker is selected without competition. For all instances where this method has been used by the City, the incumbent (current) broker has been appointed. Because of the lack of competition, the City has not demonstrated that the best coverage was obtained at the most reasonable cost in those instances.

In contrast to the two methods used by the City, our surveys of ten other local governments showed the "Broker of Record Method" was the only method used by those entities for acquiring commercial insurance coverages. Under that method, the broker is competitively selected (through a RFP process) separate from the acquisitions of the desired insurance coverages. Criteria used in the selection of brokers under this process generally include consideration of broker fees/compensation as well as the experience and ability to provide the needed brokerage services.

After a broker is selected under the "Broker of Record Method" and a contract is successfully executed, the governmental entity instructs the broker to go to the applicable insurance market (property, liability, etc.) and obtain proposals from willing and capable carriers for specific coverages when determinations are made those coverages are needed. Those carrier proposals are obtained and presented to the governmental entity for evaluation and selection (generally in consultation with the broker).

Compensation paid to brokers selected under the "Broker of Record Method" is generally controlled by the governmental entity through contractual terms that pay the broker an annual flat fee for services and/or limit the amount of commission a broker can accept and retain from insurance carriers awarded the coverages. Controlling compensation in this manner helps ensure objectivity by the broker when soliciting and obtaining carrier proposals on behalf of the governmental entity. For example, it controls a broker's incentive to solicit and recommend insurance carriers that will pay the highest commission to the broker, especially in an environment where no other brokers are soliciting carrier proposals on behalf of the governmental entity.

In insurance markets where there is a relatively large population of carriers willing and capable of providing needed coverages, the "Broker of Record Method" may not employ competition to the extent that competition is used in the "Defined Coverage Method." This is because the selected broker under the "Broker of Record Method" may not have sufficient relationships with each available carrier. As a result, proposals may not be solicited on behalf of the City from all available carriers.

On the other hand, in insurance markets where there are a limited number of carriers willing and capable of providing needed coverages, the "Broker of Record Method" may be more competitive and beneficial for the governmental entity. Specifically, as also explained previously, this method will allow the governmental entity to select the "best" broker (based in part on fees) to obtain quotes from those relatively few carriers that are willing and capable of providing the needed coverages. (This is based on the premise that the willing and capable carriers will provide quotes to the selected broker.)

As stated above, evidence obtained during this inquiry indicates that there are a limited number of carriers available to provide many of the coverages needed by the City. Because of this apparent market limitation, use of the "Broker of Record Method" (or a modified version of that method) should be considered by the City.

(NOTE: A modified version suggested by the Treasurer-Clerk's Office would involve the selection of two brokers through a RFP process and then designating for each selected broker the specific carriers from which quotes could be solicited. This could be described as a combined use of the "Broker of Record Method" and "Assignment of Market Method."

Such a modified method may be feasible in an environment where there are a limited number of available and willing carriers, but one or more of those relatively few carriers are only willing to provide quotes through specific brokers.)

Broker fees/compensation paid by nine of the ten surveyed local governments, each using the "Broker of Record Method," averaged 5.11% of total premiums paid for purchased coverages. In comparison, broker fees/compensation for current coverages acquired by the City under the "Defined Coverage Method" and "Appointment Method" represents 8.8% of annual premiums payable. If the City paid 5.11% in broker fees/compensation, it would pay approximately $150,000 less annually in broker fees.

Recommendation (Question No. 6)

The Office of the City Treasurer-Clerk's Risk Management section should consider revising its methods for acquiring commercial insurance coverages. Instead of using the "Defined Coverage Method" and "Appointment Method," consideration should be given to using the "Broker of Record Method" (or an appropriately modified version of that method).

There is no guarantee that a change in methods will result in savings to the City. However, (1) the existence of a limited carrier market for many of the City's coverages, (2) the practices of other local governmental entities, and (3) the potential for reducing and better controlling broker fees/compensation all indicate that changing methods may be to the City's benefit.

Appointed Official's Response

City Treasurer-Clerk's Response:

We would like to thank the City Auditor for the professional manner in which he conducted his inquiry. While the City Auditor's inquiry confirmed our view that there are limited carriers for the coverages required by the City, his review indicated that other governments have responded to this market situation with different approaches to acquisition of coverage and that those methods may produce improved responses. Given the results of this inquiry into past practices for acquisition of commercial insurance and given similar results from a separate report by an industry consultant, we will implement the changes outlined in the action plan. In accordance with the results of the inquiry and the City Commission's action on September 25, 2013, we will first initiate new processes to acquire various non-property coverages for October 1, 2014. We will then initiate new processes to acquire property coverage for April 1, 2015. In both instances, we anticipate using the services of an industry consultant to insure that new processes used are best practices given the nature of the City's insurance program and the then-current state of the insurance markets.

Though the broker for most coverages has been unchanged for many years, the award process has been reviewed at least twice during the period under review. In the early 2000s, the process was changed from a bid-only process to a request for proposals in order to consider qualifications as well as premiums. Also, in 2005, the City Treasurer-Clerk conducted a workshop in which interested brokers were invited to participate. The purpose of the workshop was to discuss methods of acquisition of brokers and coverages. Based on that meeting, it was determined that there were a number of methods available. There was no general agreement among the attending brokers as to a "best" method, with each method seeming to have advantages and disadvantages. With no clear indication that alternatives were better, use of the current method was continued.

We acknowledge that a possible disadvantage of the Defined Coverages method previously used by the City could be blocking of the markets. With this possibility, we polled the six brokers who had expressed interest in the RFP. Two of these brokers did suggest blocking of markets; however, only one provided specific responses to the questions asked. Absent further details or documentation, we agreed with the general notion that blocking of markets was possible.

This position led to our proposal for a one-year award and a review of our process. This review and the results of the City Auditor's efforts both suggest a change in method, which we will make.

The inquiry results also noted that a limited number of proposals have been received in the last ten years. In addition to the results of the inquiry, we have noted that a limited number of brokers downloaded our most recent RFP. As a result, we will take steps to ensure that future RFPs receive broader attention from potential respondents. We hope that the combination of a change in method and broader distribution will result in greater participation in the process.

We will also develop policies to insure that any current or future coverages placed under urgent circumstances using the appointment method are added to future requests for proposals. In those circumstances where lead time for placing coverage is very limited, an appointment may be necessary to make certain that the City does not take on uninsured risk; however, subsequent placement or renewal will be incorporated into RFPs.

We appreciate the diligence of the City Auditor in reviewing the acquisition methods for coverages and the comprehensive results presented. We are pleased that coverage in all areas has been continuous with no uninsured exposure to the City, and we look forward to implementing suggested improvements with the potential to better control or reduce broker fees.

Appendix A – Management's Action Plan

Action Steps	Responsible Employee	Target Date
A. Objective: RFP (1) for Broker Selection for Excess Workers' Compensation, Aviation Liability, Pension Fiduciary Liability, EMS Professional Liability and Statutory Death Benefit Coverages for Police & Fire with October 2014 inception date.		
1) Engage consultant to prepare RFP specifications, evaluation criteria and document.	Gail Shuffler	January 2014
2) Release RFP.	Gail Shuffler	February 2014
3) Receive and evaluate responses.	Gail Shuffler	March 2014
4) Commission approval.	Gail Shuffler	April 2014
B. Objective: RFP (2) for Broker Selection for Commercial Property and Boiler & Machinery, Renaissance Building, Fine Arts and Neighborhood Stabilization policies for April 2015 inception date.		
1) Engage consultant to prepare RFP specifications, evaluation criteria and document.	Gail Shuffler	April 2014
2) Release RFP.	Gail Shuffler	May 2014
3) Receive and evaluate responses.	Gail Shuffler	July 2014
4) Commission approval.	Gail Shuffler	August 2014

Copies of this Inquiry (Report #1404) may be obtained at the City Auditor's web site (http://www.talgov.com/auditing) or via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (City Auditor, 300 South Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (auditors@talgov.com).

This Inquiry was conducted by:
T. Bert Fletcher, CPA, CGMA, City Auditor