Casualty Insurance: Elements and Best Practices

ASWM Hot Topics Webinar

Presenter: Chris Baker,
Co-Founder, Conservation United

December 14, 2021

CONSERVATION
UNITED
INSURANCE | FINANCIAL ASSURANCE | RISK MANAGEMENT

About Conservation United

- Insurance Agency: Specialized in Ecological Restoration
- Chris Baker: 23 years conservation experience in the non-profit sector

Full Disclosure

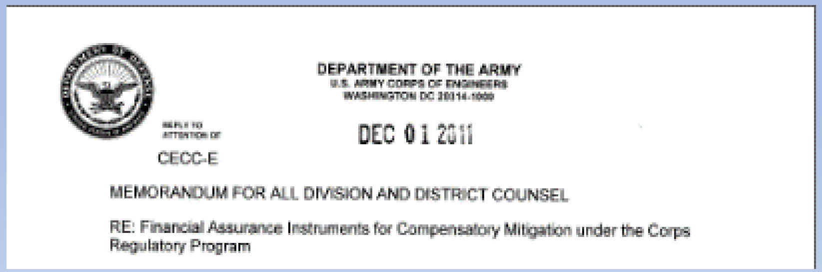
- Conservation United sells mitigation financial assurance insurance policies and bonds
  - From a A.M. Best A+ Rated Insurance Companies
  - Duration: Operational Life of Bank

Source Materials

- 2011 Memo: “Financial Assurance Instruments for Compensatory Mitigation under Corps Regulatory Forum“, Phillip Steffen, Asst. Chief Counsel for Environment

- 2016 IWR White Paper: “Implementing FA for Mitigation Project Success”, Steve Martin

- Personal Communications with Steve Martin



DEPARTMENT OF THE ARMY
U.S. ARMY CORPS OF ENGINEERS
WASHINGTON DC 20314-1000

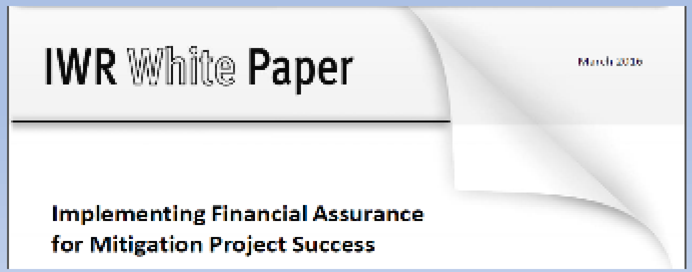
REPLY TO ATTENTION OF

CECC-E

DEC 01 2011

MEMORANDUM FOR ALL DIVISION AND DISTRICT COUNSEL

RE: Financial Assurance Instruments for Compensatory Mitigation under the Corps Regulatory Program



IWR White Paper

March 2016

Implementing Financial Assurance for Mitigation Project Success

Agenda

1) Parties and Responsibilities
2) Surplus Lines vs Admitted Carriers
3) Elements of Insurance
4) Claims: "Claims Made" policies
5) Duration: Discussion on Annual Renewal VS Multi Year
6) Evolution of FA Market – Multi-Year Bonds

The Insurance Contract

Legal Contracts: Insurance policies, bonds, and LOC's are all guided by terms of underlying MBI

- Best Practice: District Review of Policy Form as Sponsor submits first draft of MBI, not at moment of approval

Parties and Responsibilities

1) Named Insured

- Mitigation Bank – Sponsor
- Responsible for constructing, monitoring, reporting and adaptive management as defined in MBI
- Required to report changes in MBI to carrier
- Use "best efforts" to prevent Default.

2) "Regulatory Agency"

- Third Party Rights: Approve changes to MBI or policy, approve Reports, Declare Default, File Claim, <u>Approve</u> method of payment of Claim

3) Insurance Company (aka "carrier"):

- Underwriting: Consider financial strength of Sponsor relative to perceived risk of project
- Process Claims: Called "adjusting" and "settling"

Admitted Carriers

“Licensed” by states’ insurance commissions

- Standardized policy forms (language) approved by commissions
- Rates (Premium): approved by commission
- Claims/:Losses covered by State Guaranty Fund if carrier goes bankrupt.
- Generally for traditional lines such as general liability, auto, property, etc.   Large sample sizes with millions of policies sold

Surplus Lines Carriers

*FA for mitigation will always be Surplus Lines
(Performance Bonds can be Admitted)

- "Approved" by states' insurance commissions based on AM Best or Moody rating of insurance company – measure of financial strength
- Policy forms tailored to unique industries
- Ensures that the insurance market can respond to unique circumstances in specialized industries.
- Claims/Losses NOT covered by State Guaranty Fund if carrier goes bankrupt. Therefore, states approve companies based on financial strength.

  - Best Practice: Require AM Best A- Rating (or equivalent Fitch, Moody's, or Standard & Poors)

Elements of Insurance

1) Insuring Agreement: 1-2 paragraph summary

2) Declarations: Describe project, policy term, limits. Specific to each bank insured.

3) Definitions – Should align with CFR's/MBI

4) Exclusions

5) Conditions

NAUTILUS INSURANCE COMPANY
Scottsdale, AZ

COMPENSATORY MITIGATION INSURANCE DECLARATIONS

Policy Number: XXXXXXXXXX | New

INSURED'S NAME AND ADDRESS: | **PRODUCER'S NAME AND ADDRESS:**

POLICY PERIOD: October 03, 2019 to October 03, 2027 at 12:01 a.m. Standard Time at your mailing address shown above.

IN RETURN FOR THE PAYMENT OF PREMIUM, AND SUBJECT TO ALL THE TERMS OF THIS POLICY, WE AGREE WITH YOU TO PROVIDE THE INSURANCE AS STATED IN THIS POLICY.

FORM OF BUSINESS:

Limited Liability Company (LLC)

COMPENSATORY MITIGATION PROJECT(S):

XXXXX Mitigation Site
XXXXX County, NC

MITIGATION INSTRUMENT:

XXXXXXXXX Umbrella Mitigation Banking Instrument

APPLICABLE STATE REGULATION:

N/A

LIMITS OF INSURANCE

Effective Coverage Period	Per Claim	Total All Claims
10/03/2019 to 10/03/2020	$ 1,444,138	$ 1,444,138
10/03/2020 to 10/03/2021	$ 285,230	$ 285,230
10/03/2021 to 10/03/2022	$ 239,860	$ 239,860
10/03/2022 to 10/03/2023	$ 202,390	$ 202,390
10/03/2023 to 10/03/2024	$ 159,220	$ 159,220
10/03/2024 to 10/03/2025	$ 123,420	$ 123,420
10/03/2025 to 10/03/2026	$ 88,550	$ 88,550
10/03/2026 to 10/03/2027	$ 49,850	$ 49,850
Policy Aggregate Limit		**$ 2,592,658**

AT THE END OF EACH EFFECTIVE COVERAGE PERIOD, THE LIMIT OF INSURANCE SHALL EXPIRE AND WILL BE REPLACED BY THE LIMITS IN THE SUBSEQUENT EFFECTIVE COVERAGE PERIOD UNTIL POLICY EXPIRATION.

CMI DEC 05 19 | Page 1 of 2

Sample Declarations

Exclusions

*Vary by Carrier, Example from Nautilus Insurance Co.

1) "Force Majeure, or any natural catastrophe or disaster, <u>as defined in the Mitigation Instrument"</u>

2) Legal Fees/Defense

3) Fluctuation in value of credits

4) Any liability other than to pay Financial Assurances as a result of Default under MBI

- USACE Best Practice: Ensure that Exclusions align with terms and conditions of MBI.

Example: Force Majeure in Wilmington District. Damage from Flooding, including hurricanes, is not included under Force Majeure. Required an endorsement to align Nautilus' exclusion with MBI language.

Conditions

*Vary by Carrier, Example from Nautilus Insurance Co.

1) Bankruptcy: "will not relieve the Company of its obligations under this policy" *Required by 2011 Memo
2) Changes: Requires prior approval of USACE "Authorizing Agency". *Required by 2011 Memo
3) Renewal (less significant if the initial policy term covers operational life of the bank):
   - At Company's discretion, subject to underwriting
   - Follows state laws- often 45 days notice required
4) Cancellation: 120 days advance notice
   - Fraud/Misrepresentation that increases the risk originally insured
   - Named Insured's failure to comply with terms/conditions

Paying Claims

*Varies by Carrier, Example from Nautilus Insurance Co.

1) "Claims Made": Claim must be filed during Policy Period

2) Amount: determined by USACE, but must be lesser of cost of repair of insured site, or cost of replacement credits (bank or ILF)

3) Method: Pay to third party designee/standby trust OR payment to replacement contractor. Method must be APPROVED by USACE

   -compliant with Misc. Receipts Statute

   -Is a Standby Trust Necessary? Or Preferred?

Claims: Insurance Reserves

- Claims trigger carriers to establish Loss Reserve
- Claims are paid directly out of Reserves to contractors
- Best Practice: No Standby Trust should be required
- Corps approves, but does not direct use of funds

IWR White Paper: "In general, there is no need for a pre-established standby trust or for parties to be designated in advance to accept the funds because the insurance company will proffer parties to execute the work for Corps approval." Page

Denial of Insurance Claims?

Claims Process Defined by each state insurance commission – applicable to Insurance and Bonds

Example: State of California

- All insurance companies' standards fall under "California Fair Claims Settlement Practices Regulations"
- Open Claim File within 15 days
- Receive supporting documentation from Insured
- Accept or deny claim immediately (40 days maximum)
- Legal justification required for denied claims

All States: Penalties for denials in bad faith: risk license, fines up to 3X the claim amount

Duration: “Policy Period”

1) Multi-Year: Up to 10 years initially covered
- Paid Up Front: “100% Minimum Earned Premium”.

2) Annually Renewable
- Underwritten annually, with fresh review of Sponsor financials
- Point of vulnerability? Will financials reflect suspended credit sales and/or expenses for Adaptive Management?
- Preferred by some Sponsors to maximize cash flow

BEST PRACTICE: Avoid Annual Renewals?

“The limited terms of LOC’s and performance bonds, and their less than certain prospects for renewal, can be problematic for mitigation bankers and the Army Corps alike” IWR White Paper, Pg. 22

“Non-renewal of a LOC or Performance Bond could result from a negative judgment by an issuer about a mitigation provider’s ability to complete the mitigation obligation” IWR White Paper, Pg. 22

“Casualty insurance, on the other hand, does not involve complications related to limited assurance terms and uncertain renewal prospects”   IWR White Paper, Pg. 22

Will FA Expire Before Claim Filed?

- Insurance Policies are "Claims Made" – Claim must be filed <u>during</u> the policy period.
- Bonds Forms and LOC's also stipulate claims must be filed during coverage period
- What is the prescribed period of time for deficiency to be evident/reported, cooperatively develop adaptive management plan, implement plan, and allow at least one growing season to determine success? More than 1 year?

Timeline of a Claim: Annually Renewable FA

Months

1

MBI Approved
- FA placed/bound
- Initial Credit Release
- Construction Begins

3

Construction Cont.
- Earthwork
- USACE Site Visit?

6

Construction Complete
- Planting
- Establish Monitoring Plots
- Invest in Repairs?
- Prepare As Builts

9

Submit As Builts
- FA Provider Reviews Sponsor Financials
- 120 Notice Non-Renew

12

As-Built USACE Review
- USACE Site Visit?
- Deficiency Revealed
- Develop Adaptive Mgt. Plan
- FA Expires – No Coverage
- Too late to submit claims for Construction

18-24

Adaptive Mgt Implementation
- 3 months to develop
- 3 months to implement
- One growing season
- USACE Default/Claim Filed
- FA Expired > 12 months ago

How to reconcile adaptive management sequence with "Claims Made" FA?

Conclusions on Duration

- **Multi-Year FA generally provides superior security for USACE**

- **Sponsors with strong track record – Annually renewable FA may be appropriate because FA provider is unlikely to non-renew.**

- **IF all LOC's can be called if non-renewed and not replaced, that represents adequate protection. See Steve Moore's presentation of 12.07.21**

- **Requiring FA to be provided and paid in advance for life of bank could present a cash-flow burden for Sponsor. USACE should assert discretion.**

- **Multi-Year FA is no longer limited to casualty insurance.**

  LOC's are traditionally annual, but can be multi-year?

  New Orleans District: Approved bond with a Rider for 3-year term

  Wilmington District has template bond form with multi-year FA reduction schedule

Wilmington District Bond Form – Multi-Year with Declining Schedule

1) This bond shall remain in full force and effect for a period of **[number]** years. **[If the bond will be reduced on an annual basis, include the following statement and fill in the columns below.]** The Maximum Penal Sum of this bond may be reduced by the USACE, by these scheduled amounts:

Year	Reduction	Revised Penal Sum
1	$	$
2	$	$
3	$	$
4	$	$
5	$	$
6	$	$
7	$	$

USACE Cooperative Approach, Attracts New FA Providers

“Districts tend to prefer to work with the sponsor to secure successful corrective actions rather than risk potentially uncertain outcomes associated with a claim on financial assurances”

-Steve Martin, Nov. 2019

“Districts would like to see mitigation providers be successful. Successful compensation means that permitted losses are more likely to be offset by the required compensation and a successful provider is more likely to reinvest in providing additional compensatory mitigation.”

Best Practice: Should USACE Hire or Contract an Insurance/Bonding Consultant?

- USACE: has no experience pressing claims and uncertain of outcomes. No FA Claims since 2008
- No opportunity for FA instruments/providers to establish credibility
- Millions Spent on FA Annually: Little informed knowledge of what mechanisms work and why
- USACE: No insurance or bonding specialist. Responsibility flows to 38 districts, also with no insurance specialist. Burden multiplies.
- Consulting Specialist could advise, but autonomy to approve or not approve FA mechanism would remain with the District.

Thank You

Chris Baker,
601 First Street, Ste. A
Benicia, CA 94510
chris@insuranceunited.com
(928) 699-1068