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DATE: September 20, 1995

TO: Finance and Budget Committee
Cost Containment, Contracts and Efficiency Committee

FROM: Ronny Goldsmith
Chief Financial Officer

FILE

SUBJECT: Ernest and Young Report

BACKGROUND:

At the September 13, 1995 Budget and Finance Committee, Mark Smith from Ernest and Young presented a summary of the results of a Risk Management Report commissioned by the CAO in April, 1995.

Several members of the Budget and Finance Committee had questions related to the MTA's Risk Management Program.

The Study as well as the questions raised were referred to the Cost Containment Committee for further discussion.

We are prepared to address the questions raised by the Committee members and any other questions that the members of the Cost Containment Committee may have.

QUESTIONS AND ANSWERS:

1. Question: What would be the impact of converting the existing OCIP program to a traditional insurance program whereby contractors and subcontractors purchase their own insurance?

1. Answer: It is estimated that if each construction contractor was required to furnish workers compensation and general liability insurance, their bids would be higher by approximately 6.5% based upon a level of insurance comparable to the aggregate level of insurance currently purchased by the MTA. This analysis assumes that construction contractors reduce the current fees charged to the MTA by the savings they experience because they are not required to purchase insurance.

It is important to note that the OCIP affords insurance to certain contractors and subcontractors who otherwise would potentially be excluded from obtaining coverage on their own due to affordability or availability.

Lastly, the overall quality of the MTA insurance program could be adversely effected if contractors and subcontractors were required to supply their own insurance. Extensive analysis and continual monitoring would be required by the MTA to determine if coverage was in place; if the coverage levels were sufficient; and if the insurance carriers were financially sound.

2. *Question:* What is the cost of potential claims arising from defective design work compared with the savings realized from the OCIP program?

2. *Answer:* Potential claims arising from defective design are insured under the master professional liability OCIP (Errors and Omissions Insurance). The cost of Errors and Omissions Insurance Premiums represents approximately 20% (or $5 M annually) of total annual insurance premiums of $24M. A portion of the premium is returned to the MTA depending on loss experience.

No claims have been paid under the Errors and Omissions OCIP. Claims have been filed in connection with Hollywood Boulevard.

As part of the Broker RFP process, proposals will be solicited for alternative and potentially more cost effective errors and omissions insurance programs.

3. *Question:* Do claims arising from defective design increase under Errors and Omissions OCIP Programs? What has been the errors and omissions claims experience of other construction projects of similar size under OCIP's compared with traditional contractor supplied insurance?

3. *Answer:* Errors and Omissions claims are typically infrequent on major construction projects. Although infrequent, when they do arise, they can be severe.
Ernest and Young is not aware of any other Project Owner that provides Errors and Omissions coverage for contractors. The following Project Owners were surveyed:

- Long Island Railroad - $57M Penn Station Renovation
- Long Island Railroad - $54M Rail Electrification Project
- MTA-Baltimore Central Light Rail - $364M Tunnel and Surface Rail
- MTA-Baltimore-$350M Subway Tunnel Extension Project
- DART Light Rail-$850M-Tunnel and Surface Rail Project
- Boston Harbor Tunnel-$1.75B
- Garden State Parkway-$750M Highway Project
- New York City School Authority-$1.73B Construction Program
- Port Authority-$2.7B Airport and Bus Terminal Construction Program

4. *Question:* What Project Owners have bonus programs for safety?

4. *Answer*: The following Project Owners were surveyed:

-Long Island Railroad
-Metro North Commuter Railroad
-New York City MTA

Each agency has developed and implemented safety incentive programs for their operations and construction activities. The programs include components of accident frequency and accident severity. Bonuses including cash, gifts, days off etc. are awarded if a targeted number of days are worked in which the frequency and severity of accidents falls within an established threshold. Bonuses are paid directly to contractors employees rather than paying the bonus to the contractor and depending upon the contractor to disburse the bonus to the contractor's employees.

As part of the Third Party Administrator RFP process, proposals will be solicited for Construction and Operations Safety Programs tailored to address and improve the MTA claims experience.

5. *Question*: Do any project owners have claims "disincentive" programs based upon the number and severity of OSHA citations received by contractors and subcontractors?

5. *Answer:* No project owners surveyed had claims "disincentive" programs.

6. *Question:* Please provide a summary of workers' compensation reserves by construction project and for operations.

6. *Answer*: A summary of workers' compensation reserves will be provided at the committee meeting..

7. *Question:* What is the background of the consultants who worked on the Ernest and Young Report? What is the cost of the report?

7. *Answer:* Please refer to the attached resumes for the background of the consultants who were involved with the Ernest and Young Report.

The final cost of the report including expenses is estimated to be $211,000.