Title of Report:	**Insurance fund**
Report to be considered by:	Overview and Scrutiny Management Commission
Date of Meeting:	2 December 2014

Purpose of Report: **To introduce to the Overview and Scrutiny Management Commission background information for the examination of the operation of Council's Insurance Fund.**

Recommended Action: **To note the contents of the report and conduct scrutiny accordingly.**

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Executive Report

1. Introduction

1.1 At its meeting of 8 April 2014, the Overview and Scrutiny Management Commission agreed to examine the operation of the Council's Self Insurance Fund.

1.2 In requesting that the topic be considered, Councillor Alan Law advised that the Commission's review should:

(1) Identify and recommend the required level of reserves to be held in the fund
(2) Recommend the balance that should be held between the assumed level of risk and size of the reserve
(3) Review the last 3 years of claims and performance.

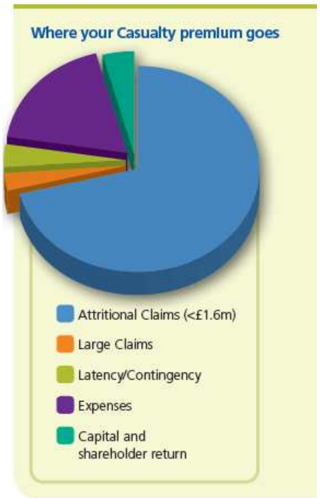
1.3 The aim of this report is to provide a brief outline of the way insurance operates at West Berkshire Council to provide an understanding of the purpose of the Insurance Fund.

1.4 The report covers the following:

(1) Purpose of insurance
(2) The Council's approach to insurance
(3) The Council's risk appetite
(4) Fund size
(5) Outline of how the Fund works at WBC
(6) Outline of the key results of the Actuarial review
(7) Other pressures on the Fund
(8) Claims governance and performance

2. The purpose of insurance

2.1 In common with most organisations the Council uses insurance to transfer financial risk. In return for a premium, an insurer guarantees to pay for insured losses. Insurance simply allows the Council to smooth the cost of losses over the longer term and share the impact of losses with other insured organisations, but at a significant cost. The chart below, provided by Zurich Municipal (ZM) which is currently one of the Council's insurers, outlines how an insurer uses premiums.



2.2 The graph relates to Casualty (Liability) Insurance, and indicates that roughly 75% of the premium goes towards paying claims and that the remaining 25% covers admin and profit for the insurer. That 25% represents the cost to the Council of transferring risk to the insurer, and highlights that this form of risk transfer is very expensive. Indeed central government avoids this cost by funding its own losses, with what is euphemistically referred to as "Crown Indemnity".

2.3 The Council, however, is not able to copy central government's approach because Council funding is very limited in comparison to the potential losses that may occur. For example Shaw House is insured for £24m and Littleheath School for £30m, and our Liability insurance provides cover for claims up to £40m. Raising such sums would be problematic for the Council.

2.4 On the other hand the Council can, and does, minimise the cost of using insurers, by funding a proportion of losses incurred by taking an excess (deductible). The extent to which losses can be funded this way is determined by the size of the excess which is in turn dependent on the ability of the Council to cover losses below the excess. The insurance fund plays a key part in enabling the Council to fund such losses.

3. The Council's approach to insurance

3.1 The Council lets separate contracts for six discrete classes of insurance. These are:

(1) Combined Liability - which covers Public and Employers Liability, Professional Indemnity and Officials Indemnity (also known as Casualty).
(2) Property - for buildings and contents
(3) Motor - for the staff leased car scheme and the Highways transport fleet.
(4) Engineering - which covers statutory inspection and insurance of lifts and pressure vessels (boilers)
(5) Personal Accident
(6) Off site activities - mainly for school trips.

3.2 Of the above, only the first two have any impact of the Council's insurance fund. These contracts, with the exception of off site activities, were re-tendered in 2012 with the new contracts coming into effect on 1 November 2012. The contracts are let on Long Term Agreements (LTA) for the period of 5 years, plus 2 plus 1 - ie till 2020. The LTA works as follows:

(1) Property – the premium quoted at tender is expressed as a percentage of the total sums insured. For subsequent years the premium is then calculated by applying the same percentage to the revised sums insured.
(2) Liability – the premium quoted at tender is expressed as a percentage on the total payroll cost. For subsequent years the premium is calculated by applying the same percentage to the revised payroll costs

3.3 The above works well for property, and, in normal circumstances for liability. However, over the last few years a combination of pay restraint and cuts in staffing has meant that liability premiums have fallen within LTA's. However, cuts in staffing have increased risk as layers of management and associated controls have been removed from councils. This may help explain the decision of Travelers (the Council's previous insurers) to break all of their LTA's with councils over the last 12 months, requiring very significant increases in premiums.

3.4 As noted above the principle remains that the better able the Council is to fund its own losses the more cost effective that will be, over the long term. The way the Council manages this is through taking an excess (deductible in insurance speak), and by not purchasing insurance for some risks.

3.5 The ability to fund losses derives from the size of the insurance fund. The larger the fund, the higher the levels of excess that can be managed and the lower the premiums will be. Two examples illustrate the effect:

(1) A County Council operate with an excess of £5m per claim. To support this they have an insurance fund of £35m. Premiums for this County Council will be, relatively, very low as a consequence.
(2) Until 2006, West Berkshire Council operated with an excess of £25k on liability, after when it was increased to £100k. In return for taking an extra £75k risk per claim the insurer reduced the annual premium by £160k. As a consequence, over the period 1 November 2006 to 31 October 2012 the Council has saved £960k on premiums less the additional costs of claims of £320k leaving a net saving of £640k to date. (This may reduce if further claims come through for this period).

4. WBC Risk appetite for insurance

4.1 In simple terms this refers to the extent to which the Council wishes, and is able, to fund its own losses. Taking the top three insurance risks, noted in 3.1 above:

(1) Combined liability policy, is with Zurich Municipal, (from 2012, previously with Travelers) and operates with a £100k excess. Prior to November 2006 the Council operated with a £25k excess. This policy provides cover for claims up to £40m. The Council will have to fund losses above this level.

(2) Property, is with Aspen and operates with a £250k excess. This level of excess has been in place since 2000. The policy excludes subsidence and terrorism, ie the Council has to cover any such losses itself.
(3) Motor policies are with Zurich Municipal, (from 2012, previously with Risk Management Partners) – Staff Leased Cars operate with third party only cover, the Highways Transport fleet operates with a £2k excess. Prior to 2010 the Highways Transport fleet had a £250 excess.

4.2 The other factor that affects the funding of losses is the "stop loss" or "aggregate" concept. This provides a limit on the total funding of losses by the Council in any one year. The aggregates are:

(1) Property Policy - £450k
(2) Combined liability - £375k at tender in 2012, raised on renewal in 2013 to £425k, and raised again on the 2014 renewal to £468k.

4.3 The aggregates do provide a measure of certainty and they are relatively low. The main reason they are so low is that at the time of retendering the Council's insurances on 1 November 2012, no claims for either property or liability had exceeded the Council's policy excesses, so the Council's insurers had not paid a penny on either of these policies. This claims experience made the Council very attractive to insurers.

5. Size of fund

5.1 The size of the insurance fund has varied over the last 10 years. In 2004 the size of the fund was circa £400k. This was increased over the years to £1.6m, and is now £1.2m. Initially the increases were made through the use of underspends at year end. However, in circa 2009-10 the process was changed to limit further transfers into the fund and to use the fund as a safety valve for claims. So at the year end the main insurance cost centres are cleared to zero by either transferring an underspend into the fund, or transferring from the fund to cover any overspend on those cost centres.

5.2 A further change was made in 2011-12 when Management Board agreed a proposal to change the way claims are funded. Up until then 50% of the first £12k of any loss had been covered by the relevant service unit. From 2011-12 service units have to cover the first £10k of any loss. The purpose of doing this was two fold:

(1) It reduced the pressure of the cost of losses on the insurance fund
(2) It significantly increased the incentive for services to manage their risks effectively and so reduce the incidence of losses.

5.3 The Council has undertaken benchmarking of insurance within the CIPFA scheme. The table below indicates the range of insurance fund sizes in comparison with the excess for the Liability and Property insurance. What this table indicates is that WBC has the second smallest fund of the 15 Unitary Councils who provided returns.

Comparison of Reserves with levels of Excess

	Reserve £	Liability Excess £	**=A/B**	Property Excess £	**=A/D**	**=C+E**
	A	**B**	**C**	**D**	**E**	**F**
A	1,100,000	212,000	5	100,000	11	16
West Berkshire	1,200,000	100,000	12	250,000	4.8	17
B	600,000	60,000	10	50,000	12	22
C	3,200,000	155,000	21	1,000,000	3.2	24
D	7,500,000	250,000	30	250,000	30	60
E	4,000,000	100,000	40	100,000	40	80
F	4,300,000	100,000	43	100,000	43	86
G	2,900,000	100,000	29	50,000	58	87
H	1,500,000	25,000	60	25,000	60	120
I	7,900,000	125,000	63	125,000	63.2	126
J	4,700,000	100,000	47	50,000	94	141
K	5,400,000	100,000	54	50,000	108	162
L	9,000,000	123,000	73	100,000	90	163
M	2,600,000	25,000	104	25,000	104	208
N	12,700,000	200,000	64	50,000	254	318

5.4 The councils above the line in the table could be considered as “risk takers”. When you get down to Council H and beyond you are dealing with very “cautious” councils which could be considered to have more cash in their reserves than they need, for the level of excess that they are carrying.

6. Fund Review

6.1 Determining, with any precision, how much cash will be needed to hold in an insurance fund is difficult. Officers are effectively trying to predict what will happen in the future, based on what has happened in the past. If a school burns down tomorrow, then the Council will have to find £250k – if a second school then burned down the day after, then we would be looking for a further £200k (taking us up to the aggregate of £450k in total). In addition, we would also find our Property Insurer reviewing, and most likely increasing significantly, our premiums.

6.2 The way the Council and the insurance industry deals with this uncertainty is through use of actuaries. By reviewing past claims experience, an actuary will provide an assessment of the likely fund requirement to cover future claims.

6.3 The Council periodically obtains actuarial reviews through its insurance broker Jardine Lloyd Thompson (JLT). Such a review was carried out in 2012 and a further review has just been completed for this scrutiny. The review uses very complex maths to derive its conclusions. The conclusions centre on three figures.

(1) Reserve - The sum required to pay for losses that either we don’t know about yet, or are unable to predict what, if any, the financial impact might be.

(2) Provision - The sum required to fund losses that we are aware of and have a reasonable idea of the financial impact. For example, at any one time we have a large number of Liability claims in progress, most of which we will repudiate, but some of which will involve payment by the Council and very occasionally by our insurer. Sometimes we have

admitted liability and are challenging the level of compensation and we know we will incur cost.

(3) Injection - The required sum to put into the fund to maintain the Reserve / Provision to the required level. Otherwise as claims are paid the fund would gradually dwindle away.

6.4 The Council operates somewhat differently, with 1 & 2 (Reserve & Provision) combined as a balance sheet Insurance Fund. 3 (Injection) is effectively covered by revenue budget allocations that sit within the insurance cost centres, and contributions that come from service units paying the first £10,000 of each loss.

7. Actuarial review

7.1 An actuarial review was completed in July 2012 and again in October 2014. Over that period the Council's position has worsened significantly. The forecast funding requirement has changed:

(1) 2012 - £1.5m
(2) 2014 - £2.4m

7.2 In addition the review is predicting that the Aggregate for Liability cover will be breached for 2009/10 and that on renewal in 2014 our insurer is likely to require a significant increase in the Aggregate. Indeed, as already noted, the Liability Insurer ZM has in fact increased the aggregate.

7.3 There are a number of reasons for the worsening position. These are:

(1) A number of claims are now being settled at significantly higher cost than was anticipated. For example on re-tender in November 2012 the Council's Liability insurer had not had to pay out on any claims for the previous 5 years. However, this position has now changed significantly and it now appears likely that the insurer will end up paying more in claims than they received in premiums.
(2) The estimate of the costs relating to the insolvency of Municipal Mutual Insurance (MMI) have risen significantly.
(3) Claims are coming through relating to Mesothelioma from the 1960's when no insurance cover was in place.
(4) No allowance was made for property losses in the 2012 Actuarial review, but these have been included in the 2014 review.

8. Fund pressures

8.1 There are a number of additional pressures, both actual and potential that need to be considered when determining an appropriate level of funding for the insurance reserve. These include:

(1) The MMI failure
(2) Additional significant claims
(3) Claims handling costs
(4) Tightening of the insurance market for liability insurers

8.2 Of the above 1 & 2 have been covered by the actuarial review. 3 was a particular problem in 2012-13, with over 500 liability claims in the year. The insurer provides a price to handle claims based on an estimate of the number of claims. Their initial estimate based on past experience was around 250. Consequently the fee increased by £20k in 13-14 to take account of the higher numbers.

8.3 The tightening market in Liability insurance is a particular problem that has emerged over the last 18 months. At present there are only 3 insurers that are competent and willing to tender for local authority liability insurance. These are Risk Management Partners, Travelers and Zurich Municipal. Approximately a year ago Travelers started breaking all of the Long Term Agreements they have by requesting increases in premiums ranging from 300% to 800%. The reason for this was that the company realised the level of losses they had on their books was actually much higher than they had thought. Different councils reacted in different ways. In some cases they took an increase in their excess as an alternative. For example a council moved their excess from £250k to £500k. Others have retendered, but even then have faced increased premiums.

8.4 West Berkshire Council moved from Travelers to ZM in the 2012 retender, to take advantage of a small reduction in premium. Consequently we were not immediately affected. However, ZM have now increased our premiums above the rate set in the LTA by 52% from 1 November 2014. Given the very limited market the option of retendering the contract was considered to be unviable. ZM have outlined the reasons for the increase, see appendix A.

9. Claims performance

9.1 The critical area of insurance, in terms of performance, is Liability claims. Property is straightforward – losses are clear cut. With liability a claim can be made some years after the date of an incident. Once a claim is made it can take a number of years to resolve, particularly if the claim goes all the way to court. This element of the report therefore focuses solely on liability claims.

9.2 Note that the effective date, for determining which insurer deals with the claim, is the date the incident / issue occurred, not the date the claim is made or the date payment, if any, is made.

9.3 There are three areas of potential conflict over any claim.

(1) Whether we are liable
(2) If we accept liability then the level of compensation is open to question.
(3) The level of legal fees of the claimant’s solicitors can be challenged.

9.4 All of the above are open to “negotiation” or formal mediation – ultimately the final arbiter is the Civil Court, with decisions being based on the balance of probabilities.

9.5 The range and complexity of these claims is considerable. There are a number of issues worth noting:

(1) A key feature of liability claims is the way the scale of the claim grows significantly as solicitors become involved, on both sides, and as a case heads towards a court hearing. So a personal injury claim of say £2000 may end up costing around £30,000 if the claim goes all the way to court, and the Council loses and may still cost around £5,000 (our costs) if the Council wins.
(2) The claims can take time to materialise – which can make analysing liability very difficult. Also, with the exception of Highways

Maintenance, who have the highest volume of claims, record keeping tends, to be less good. Liability claims are often complex, with case law playing a major part.

(3) Even when a high volume of claims are received, as in 2012-13 the insurance team have to focus on the claims that are heading into court, because they are, by then, usually large claims and also because it is imperative that the Council wins cases in Court. The Insurance Team aim to determine liability and settle quickly any claims that we feel the Council cannot win and so avoid the involvement, and cost, of solicitors.

(4) The value of the claims varies significantly. Damage to a vehicle caused by a pothole can lead to a claim of less than £100. At the other extreme the highest paid, liability, claim to date incurred a cost of £680k. The Council bore the first £100k leaving the insurer to cover the remaining £580k.

9.6 The fact that we appear to live in a “compensation culture” does not help. See appendix B for the view of the Local Government Association.

10. Governance Arrangements

10.1 The Council's scheme of delegation provides that the Head of Finance will be responsible for "All insurance arrangements and settlement of claims." (Para 3.5.18 of the Scheme of Delegation).

10.2 Our insurers actually handle the claims on our behalf. However, as in the vast majority of cases claims fall below the excess and will be paid for by the Council, the Insurance Team in Finance have a very close oversight of all claims.

10.3 The Council retains full control of decision making around claims, until the value of the claim approaches the excess. There is then a shared ownership of the claim, unless the value significantly exceeds the excess, then the insurer takes full ownership of the decision making process. In practice, limits are not defined precisely, because each claim is unique. Also there will always be consultation between the Council and insurer, regardless of the value of the claim.

10.4 Where the Council has control of the claim, decisions on low value, usually up to £10,000 claims, are determined by the Chief Internal Auditor, on advice from the Senior Insurance Officer, and in consultation with the Head of Service where the claim sits. For claims beyond £10,000 then the Head of Finance with the Head of Legal take any decision, again in consultation with the relevant Head of Service. There is full auditable trail which covers the process followed in these cases.

10.5 In addition, the Insurers, in consultation with the Council have retained legal advisors for the Council’s insurance claims. On our advice, Zurich Municipal accept the use of Blake Morgan solicitors who specialise in this area of the law. Blake Morgan are involved on any complex claims and on any claims where legal action is taken by the claimant. Blake Morgan have proved exceptionally effective not only in helping us repudiate claims and but in reducing levels of settlements.

10.6 The policy we follow in the Council is to fight claims wherever we feel we can defend a claim. So for example we do not use the “economic” argument, ie we do not pay a claim where it would be cheaper to pay than it would to fight. We only pay a claim where we feel we are likely to be found liable in Court, or where we lose a case in Court. The exception to this is where the insurer may take a different view and agree settlement in cases where the value of the claim is considerably above the excess of £100,000.

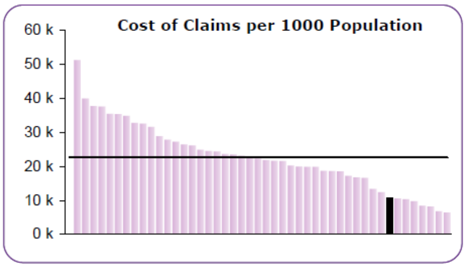
10.7 Measures of performance in relation to Liability claims are difficult to interpret, because of the complex nature of the Council's business, and the wide range of external factors that can impact on that business, eg cold winters and highways related claims.

10.8 However, CIPFA runs an insurance benchmarking service for insurance and the Council took part in this exercise in 2012 and 2014. The graphs below give a reassuring view of the Council's performance, for Liability Claims. The one area that has dipped is Employers Liability Claims “% closed claims no payment”. The percentage has dropped from 78.6% to 38.5%. The percentage shift is high because the number of claims involved is low, 14 in 2012 and 11 in 2014.

10.9 The figures are based on the five years from 1 November 2006 to 31 October 2011, for all Public Liability claims, with a comparison with 41 Unitary Councils in 2012 and from 1 November 2008 to 31 October 2013 for 37 Unitary Councils in 2014.

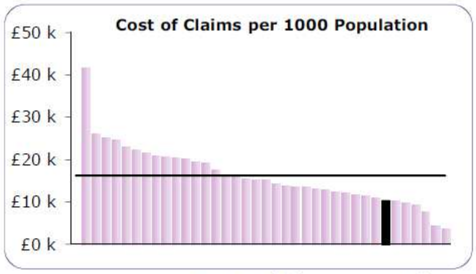
Public Liability

2012 exercise

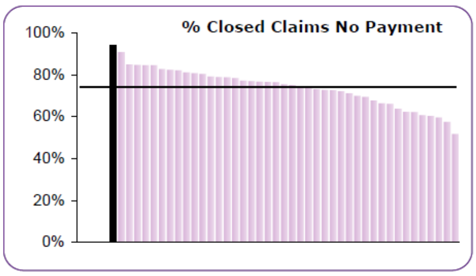


West Berkshire 10.7 k
Average 22.7 k

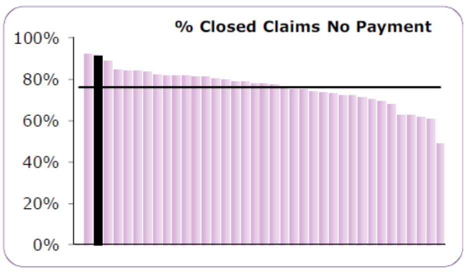
2014 exercise



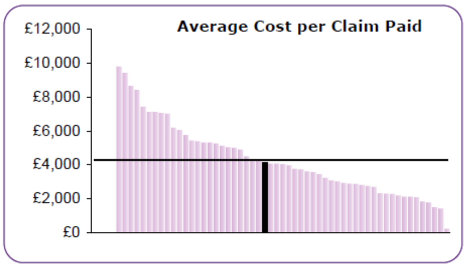
West Berkshire £10.4 k
Average £16.2 k



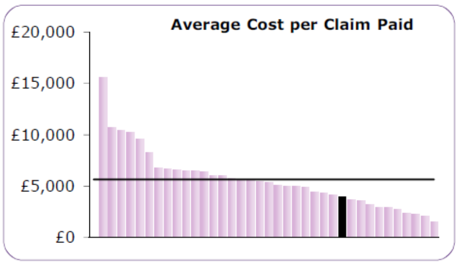
West Berkshire 94.2%
Average 74.3%



West Berkshire 91.7%
Average 76.2%



West Berkshire £4,127
Average *£4,311*

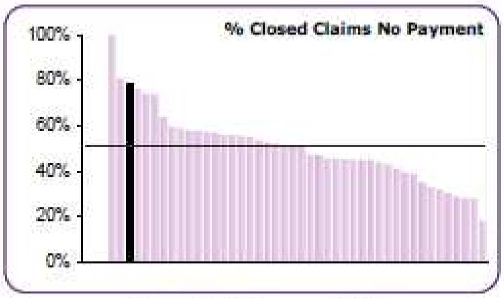


West Berkshire £3,972
Average *£5,637*

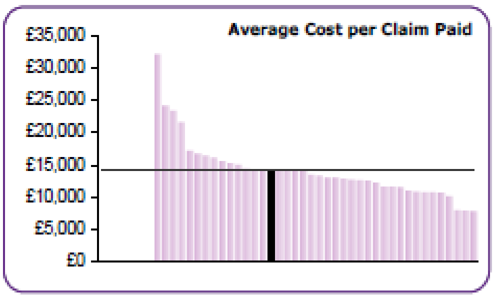
Employers Liability

2012 exercise

West Berkshire 92 k
Average *158 k*

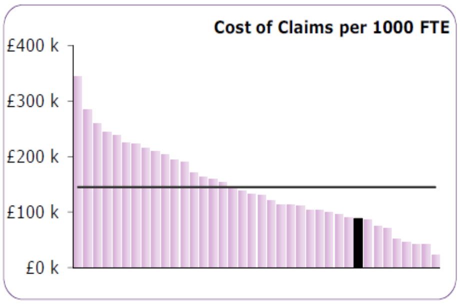


West Berkshire 78.6%
Average *50.8%*

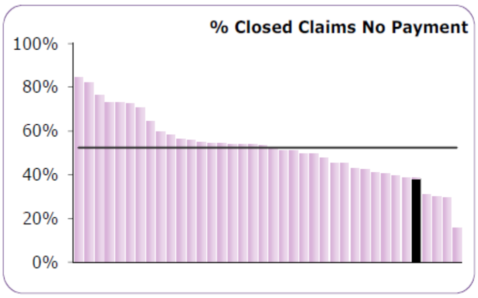


West Berkshire £14,333
Average *£14,167*

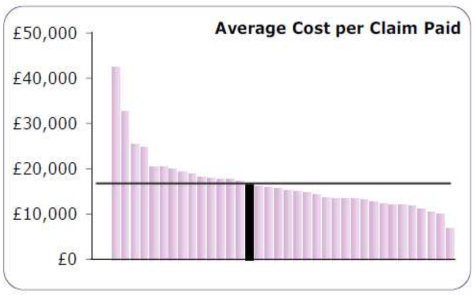
2014 exercise



West Berkshire £89 k
Average *£145 k*



West Berkshire 38.5%
Average *52.5%*



West Berkshire £16,750
Average *£16,853*

10.10 A more detailed summary of the claims experience for the Council is set out in Appendix C. This covers all claims made over the last 5 years.

11. Conclusions

11.1 The insurance market, for liability insurance, has changed significantly in the last two years, and premiums are rising very steeply. At the same time the volume of claims being dealt with by the Council is rising. This reflects not just the Council's experience, but also the wider public sector experience, as outlined by Zurich Municipal. On top of this the Council's recent claims experience has worsened, and this is reflected in the recent Actuarial review.

11.2 The recommendation from the Actuary is that the Council should add to the £1.2m insurance fund. In fact, given recent claims settlements, it is anticipated that the fund will reduce further in this financial year.

11.3 Maintaining an insurance fund provides financial security to the Council, ensuring that claims can be paid without an immediate impact on the bottom line. It also provides flexibility, so that as premiums rise, there is the option of raising the level of the Council's excesses, as a way of offsetting the impact of premium increases. This, as noted, worked successfully in 2006.

11.4 However, given the financial challenges facing the Council, it is unlikely that additional funding will be made available to increase the size of the insurance fund.

12. Recommendation

12.1 The Council should continue to hold an insurance fund, adding additional funding if and when the Council's financial position improves. The size of the fund should reflect the advice of the Actuary, ie presently £2.4m.

12.2 The Council should continue to look at the option of increasing further the levels of excess carried, in order to minimise the impact of rising premiums, where this appears cost effective.

Appendices

Appendix A	Zurich Municipal briefing re premium increases
Appendix B	Local Government Association – press release 11 August 2014 "no win no fee compensation culture"
Appendix C	Claims summary, all claims made in the last 5 years.