CHESHIRE FIRE AUTHORITY

ITEM: 7

MEETING OF	**:**	**FIRE AUTHORITY**
DATE	**:**	**12TH FEBRUARY 2014**
REPORT OF	**:**	**HEAD OF FINANCE**
AUTHOR	**:**	**PAUL VAUGHAN**

SUBJECT : REVIEW OF INSURANCE ARRANGEMENTS

Purpose of Report

1. This report proposes a different way of covering the Authority's insurance risk, and seeks Member approval to pursue the alternative arrangements outlined in the report.

Recommended: That Members agree that the Authority should:

[1] Participate in a pooling arrangement as part of its insurance portfolio;

[2] Utilise a pooling arrangement for its corporate property, liability, motor and other miscellaneous insurance requirements for a minimum of three years through a pooling entity (with the intention of this being in place from 1 November 2014);

[3] Become a full member of a pooling entity (a company limited by guarantee), formed by Fire and Rescue Insurance Consortium (FRIC) managers which will be used to manage the pool, and to authorise the Head of Finance and the Head of Legal and Democratic Services to take all necessary steps to achieve this, provided that they are satisfied with the legal documentation (which must adequately describe the obligations, liabilities and risks as well as governance arrangements associated with the pooling entity); and

[4] Participate in a financial guarantee for supplementary payments should claims against the pool exceed the funding available and authorise the Head of Finance to take all necessary steps to achieve this.

Background

Present Arrangements

2. The Authority is a member of the Fire and Rescue Insurance Consortium (FRIC) along with eight other fire and rescue authorities. FRIC procures insurance on behalf of its nine members. During the summer of 2013 a tendering exercise took place using the Government

Procurement Service in partnership with PRO5 (a group of local authority buying consortia). Zurich Insurance won most of the business. This was intended to be a short term arrangement. It runs until October 2014, with an option to extend for one year.

Information

Insurance Cover

3. The insurance held by the Authority at present includes the following:-

Property	**Liability**	**Motor**	**Engineering**	**Additional Covers**
Material damage	Public liability	Motor vehicles	Engineering insurance	Fidelity guarantee
Works in progress	Officials indemnity	Motor uninsured losses		Personal accident
Business interruption	Employers' liability			Business travel
Money	Libel and slander			Computer
Theft				Terrorism

Present Insurance Costs

4. The cost of insurance premiums paid by the Authority in 2013-14 is £384k. The premiums for 2013-14 are quite favourable as a result of the recent procurement, but are expected to rise, possibly significantly.

Market Conditions/Alternative Arrangements

5. The members of FRIC believe that under the present market conditions there is very little scope to make further savings. Many insurers are unwilling to recognise the improvements in risk management and the declining activity levels of fire and rescue authorities and will simply not engage at all in the market. As a result of this, bearing in mind that savings need to be found wherever they can, FRIC considered whether there were alternative arrangements which might be appropriate.

6. One possibility which the members of FRIC believed was worthy of further consideration was the use of a pooling arrangement. In order to better understand how this might work, FRIC engaged a specialist company, Regis Mutual Management Ltd (Regis) to undertake a feasibility study into such an arrangement.

What is a pooling arrangement?

7. Instead of paying premiums to an insurance company, FRIC members would pay them into a pool. The pool would be held by a separate legal

entity and be professionally managed on behalf of FRIC. Claims made by FRIC members below an agreed threshold would be considered by the pool managers and, if accepted, would be met from the pool.

8. The pooling entity would also procure two types of insurance. One would be to cover the FRIC members against single claims above the threshold. The other would be to cover against total claims being above the agreed level in aggregate. These insurances would take the form of a master excess policy covering every member of the pool. In this way each member is insured for claims that are not met by the pool. If there were no claims during the year, the insurers that would be prepared to provide the master excess policy have indicated that they would be prepared to return some profit to the pool.

9. The pool could allow FRIC members to have different levels of cover depending on risk appetite and financial strength.

Financial modelling of a pooling arrangement

10. The way in which the pool could work financially is shown in the table below. The model assumes that premiums are at the November 2012 to October 2013 level. The claims experience used in the model is based on the last 5 years experience of FRIC members, and is not averaged but is replicated year for year (so, for example Year 5 is modelled on 2012-13, Year 4 2011-12 and so on). In this way the model includes one year when there were significant individual claims (Year 2), which is helpful in estimating the realistic potential impact on the pool.

Insurance Pool

Modelled Scenario based on historic claims experience

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
	£000	£000	£000	£000	£000	£000
Income						
Contributions	3,718	3,830	3,944	4,064	4,185	19,740
Investment Income	7	7	8	12	11	45
Total Income	**3,725**	**3,837**	**3,952**	**4,075**	**4,196**	**19,785**
Expenditure						
Master Excess Policy	1,325	1,365	1,406	1,448	1,491	7,035
Retained Claims	2,100	2,163	2,228	1,053	1,526	9,070
Operating Expenditure	491	505	520	535	550	2,601
Total Expenditure	**3,916**	**4,033**	**4,154**	**3,036**	**3,567**	**18,706**
Surplus						
Surplus generated in year	(191)	(196)	(202)	1,039	629	1,079
Profit Share	95	0	101	104	107	407
Supplementary call	96	196	101	0	0	393
Ultimate Surplus	**0**	**0**	**0**	**1,143**	**735**	**1,879**

Notes to the model

Note 1 Income

- **Contributions** is the equivalent amount which would previously have been paid by FRIC members to an insurance company, based on 2012-13 premium levels. In 2012-13 Cheshire's share of premiums was around £430k.

- **Investment income** is an estimate of interest earned on the contributions.

Note 2 Expenditure

- **Master Excess Policy** is the premium paid to insurers to purchase the insurance described in paragraph 8 of the report, based on Regis's best estimate.

- **Retained claims** are the estimated amounts paid from the pool as the result of successful claims against it. As the model shows, in recent years the value of claims has been reducing.

- **Operating expenditure** is the cost of employing professional managers for the pool, based on Regis's best estimate.

Note 3 Surplus

- **Surplus generated in year** is the difference between the income and expenditure. Where this is shown in brackets this is a loss.

- **Profit share** is an amount returned to the fund by the excess insurers as a share of their profit.

- **Supplementary call** is an additional amount from FRIC members over and above the regular contributions to ensure that all costs of the pool are covered. The model assumes that the contributions available equate to the premiums in 2012-13. Given the assumptions used, the model shows that this would not be sufficient in years 1, 2 and 3, when additional funds would need to be made available. Based on the current premium split between FRIC members, Cheshire's share of this would be around £40k over the three years. The supplementary call would not be necessary in years 4 and 5 as the model shows surpluses in those years.

Note 4 This model demonstrates that, given the assumptions used, the arrangement will generate a surplus over the first five years of operation. The level of surplus shown in the model is £1.8m over 5 years. Based on the current premium split between FRIC members, around £150k of this would be Cheshire's surplus. Whether this would be returned will depend on the overall financial position and projections of the pooling entity.

What are the benefits of the pooling arrangement?

Financial

11. The proposed new arrangements are intended to save the Authority money. Whether this will manifest itself in a reduced budget requirement is difficult to predict.

12. The main purposes of the new arrangement are:
- to provide for improved claims handling;
- to extend the market for the required insurance; and
- to protect against continuing increases in insurance provision.

13. In addition the FRIC members will rank together to continue to reduce the insurance burden.

Risk Management

14. FRIC offers opportunities for benchmarking, sharing of best practice and an increased incentive to improve risk management amongst all the members. The shared approach to risk management provides a significant opportunity to drive down both the direct and indirect costs associated with incidents which lead to insurance claims. All of the benefits of improvements in risk management would fall to participating authorities rather than increased profit for existing insurers.

Increased market

15. The structure is attractive to supporting insurers, demonstrating a desire on the part of the members to control claims and also moving the insurers away from attritional losses (i.e. a number of small losses).

What are the risks of the pooling arrangement?

Financial

16. The model above is based on reasonable assumptions. However, insurance claims are by their nature volatile. The model shows the impact of some volatility, and demonstrates the need for supplementary contributions particularly in the early years. This is mitigated by the aggregate insurance which supports the pool, and the employment of professional support to manage the operation of the pool.

Claims

17. The pool managers have discretion about what claims should be met from the pool. Given that the parameters for consideration of claims would be set by FRIC members, the risk of claims being rejected should be less than on a typical insurance arrangement.

Ongoing viability

18. The pool relies on the continued support of its members. If any of the members withdraw, this could threaten the viability of the pool. A clear commitment to make the pool work is required from all members.

19. If new members are admitted there is a risk that the pool may be exposed to increased risk, depending on any new members' ability to manage risk. Potential new members would be subject to scrutiny before being allowed to join the pool.

20. The pool also relies on being able to attract insurers for the Master Excess Policy. The feasibility study carried out by Regis included some research into this and concluded that there is an appetite from insurance companies.

What legal form does a pool of this sort need to take?

21. The legal structure of the pool entity would be as a company limited by guarantee with members not shareholders. This structure limits liability of each member in the event of any company default. Each member would have one vote at the AGM and the membership would elect a Board from amongst their number. The Board is non executive and would contract with professional support to manage the company on a day to day basis. The Board would make all policy decisions and the managers would operate within that policy.

Timing

22. FRIC has entered into an agreement with Zurich Insurance which lasts for a year from 1 November 2013 with an option to extend for one year. Therefore, the earliest date at which the pool could operate from would be November 2014, but FRIC has the option to delay until November 2015.

Financial Implications

23. The financial implications are described in the report.

Legal Implications

24. If approved, the proposal will involve the Authority becoming a member of a separate legal entity. The Authority has the power to do so, but it is important that the governance arrangements for the entity are adequate in order to protect the Authority.

Equality and Diversity Implications

25. There are no known equality and diversity implications.

Environmental Implications

26. There are no known environmental implications.

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BACKGROUND PAPERS: NONE