HARINGEY COUNCIL

Agenda item: **[No.]**

Executive **On 31st October 2006**

Report Title: **Establishment of a London-wide Mutual Insurance Company**
Forward Plan reference number (if applicable): **[add reference]**
Report of: **Acting Director of Finance**

Wards(s) affected: **All**	Report for: **Key decision**

1. Purpose

1.1 To advise Members of the proposals to create a London-wide mutual insurance company and the risks and benefits of participation in the mutual.

1.2 To agree to Haringey's participation in the mutual, subject to its successful implementation in 2007 and its ability to fulfil Haringey's insurance requirements.

1.3 To provide a financial guarantee of up to £1million to assist the establishment of the mutual and enable Haringey to participate as a full member.

2. Introduction by Executive Member

2.1 Membership of the LAML gives us the opportunity to participate in a London-wide mutual insurance company, thus saving the council tax payer up to 15% on Haringey's anticipated insurance costs. I am convinced that going down this route will yield future savings which can then be used to further develop our services to the people of Haringey.

3. Recommendations

3.1 To agree to Haringey's participation in the mutual, subject to its successful implementation in 2007 and confirmation that the new arrangements will provide value for money.

3.2 To provide a financial guarantee of up to £1million to assist the establishment of the mutual and enable Haringey to participate as a full member.

3.3 To agree to nominate the Director of Finance to become a board member of the mutual, subject to appropriate indemnity insurance being provided.

Report Authorised by: **Acting Director of Finance**

Contact Officer: **Anne Woods, Head of Audit and Risk Management**

4. Head of Legal Services Comments

4.1 External legal advice has been sought for the proposal by the lead authority, the London Borough of Croydon, and reported through the project steering committee.

4.2 The external advice provided concentrated on three areas namely powers, procurement and competition/ state aid. That legal advice is as follows:

Powers

4.3 The external lawyer's view is that the participating Councils have the power to establish the LAML and to participate in obtaining services from the LAML, the external advisers rely on Section 2 of the Local Government Act 2000 where a 'local authority has power to do anything which it considers likely to achieve the promotion or improvement of the economic, social or environmental well being of its area' In determining whether or how to exercise the power must have regard to their community strategy. The power must not be used to raise money or do anything which an Authority is unable to do by virtue of any prohibition, restriction or limitation. Legally what is an innovative scheme is not free from possible challenge, as the extent of the well being powers have not been fully tested and the scheme may not meet all the public law considerations such as reasonableness or sufficiency or relevance.

Procurement

4.4 Insurance is considered a schedule A service to which the full EU procurement rules are applicable. The EU rules may not apply where there is procurement of insurance services by a Council with the LAML, where a public authority contracts with itself (or with a body that the Council exercises control, which is similar to that it exercises over its own departments). As it is envisaged the participating authorities will wholly own the company it is likely that these exemptions as to procurement will apply. Where LAML procures third party services the EU procurement rules generally will apply, however the legal position expressed will require further investigation.

State Aid / Competition Law

4.5 Competition rules sanctions apply where there is a competitive agreement(s) between undertakings (Article 81) or an abuse of a dominant position (Article 82), the external lawyers advise recognises that on the face of it the scheme may fall foul of Article 81, however the advice states because the proposed insurance contracts will be limited to 3 years and they do not obligate the Councils to insure with LAML, the insurance agreement may not be considered restrictive. The external lawyers also suggest that exemptions under the Competition rules may also be available.

4.6 External lawyer advice considers that since both the participating Councils and the LAML are public undertakings, the payment of premiums or the provision of capital would not constitute state aid. Advice is that state aid issue would only arise if the LAML offered insurance to non public authorities on discounted terms by reason of the application of public funds to defray the costs of supply.

4.7 The Head of Legal agrees in principle to the scheme subject to further inquiry as to the precise legal parameters and the premium and insurance terms being competitive/value for money.

5. Local Government (Access to Information) Act 1985

1. Financial Plan for the Mutual
2. 'How does the Mutual work' document
3. LAML Accounting Issues
4. Memorandum and Articles of Association of the Mutual and Rules of the Mutual
5. Advice from Roger Henderson QC on legal powers
6. Advice from Rhodri Williams QC on procurement
7. Advice from Julian Maitland-Walker solicitors on competition law and state aid
8. Advice from Weightmans solicitors on directors' responsibilities, probity controls and information management.

6. Strategic Implications

6.1 The vision for the future in Haringey's Community Strategy includes 'improving the quality of life for the people of Haringey...' to be achieved through five key priorities. Those priorities, in particular improving services and improving the environment, are key to achieving an improvement in the well-being of the area and is clearly underpinned by the Council's commitment to value for money.

6.2 The government's efficiency agenda including through Gershon make clear that improved value for money can be secured through joint procurement and shared services.

6.3 This proposal demonstrates the Council's commitment to achieving an improvement in the well-being of the area and the economic well-being of the authority.

7. Background

7.1 This report describes the proposal to establish a 'mutual' insurance company controlled by, and run for the benefit of, participating London authorities. An insurance mutual is a joint venture controlled by its members. The members insure with the mutual, instead of with commercial insurers, and they pool risks and share costs.

7.2 A steering committee of London Treasurers, assisted by working groups of London Borough Risk managers, and acting through the London Borough of Croydon, has been evaluating a proposal to create an insurance mutual. The project has been supported financially by the London Centre of Excellence (LCE). The steering committee and the LCE commissioned Charles Taylor Consulting PLC (CTC) to carry out a feasibility study using data from 26 authorities: London Boroughs, the City of London and the GLA.

7.3 CTC reported that a mutual would offer its members savings of 15% on average on insurance premiums for liability and property insurance and accumulate estimated surpluses in excess of £8 million over the first five years of trading. The steering committee has employed the services of experienced consultants to assist in the preparation of projected operating income and expenditure and these figures are estimates based on their financial model. The final figures will depend on a number of other detailed issues to be resolved in the final planning stages and of course the final actual procurement. Any surpluses would be available to members and could be used to reduce premiums further. This saving reflects the additional purchasing power and cost sharing characteristics of a mutual.

7.4 Haringey currently insures with AIG for liability and property insurance and Zurich Municipal for motor insurance. The total 2006/07 annual cost of liability, property and Motor insurance is £1.47 million. These contracts were competitively tendered and have been in place since April 2005 and expire on 31st March 2008.

7.5 Over recent years, Haringey has chosen to 'self-fund' some of its risks in order to reduce premiums on some policies. These 'deductibles' operate like the 'excess' provision in household or motor insurance policies. In Haringey, they account for the majority in number of claims. In 2005/06, Haringey's self funded actual payments totalled £2 million against its liability policies and the insurance reserve totalled £10.3 million as at March 2006.

7.6 The 'London Authorities Mutual Limited' (LAML) has been set up as a shell company, but is not yet operating. It can only operate when a sufficient number of London authorities agree to take part and when the Financial Services Authority (FSA) registration has been completed.

7.7 LAML is a company limited by guarantee. London authorities that wish to take part in the mutual will become full members and have equal voting rights. They will agree to take part in the mutual arrangements and will appoint the board of directors to run the company. Each year, the company will issue policies of insurance to the full members in accordance with their circumstances at the time.

7.8 It is recommended that the directors should be selected from the Finance Directors of the full member authorities. LAML will indemnify the directors against any personal liability and will place insurance to back up the indemnity. Directors will determine the strategy of the company and monitor performance.

7.9 Day-to-day management of LAML, including administration, issuing annual policies, arranging reinsurance and investing LAML's funds will be handled by an experienced firm of 'pool providers'. LAML will procure these services by competitive tender.

7.10 Members may be aware that Municipal Mutual Insurance (MMI), which operated as a mutual, was a major insurer for local authorities. MMI ceased trading in September 1992 and is currently in solvent run-off. Members need to be satisfied that the model of the proposed mutual is different from that of MMI. The key differences are:

a) the MMI Group in its latter period of operation was not focused purely on the public sector whereas LAML is constitutionally restricted to providing insurances to local government in London;

b) the influence exercised by local authorities over MMI was diluted in the latter years;

c) the regulatory and compliance regime under which the LAML will operate is more onerous than any under which MMI operated;

d) the structure of the insurances MMI offered did not incentivise the practice of risk management, whereas the insurance programmes provided by the LAML require and reward good risk management practice, and;

e) MMI's investment portfolio was heavily biased towards commercial property. LAML will adopt an investment strategy which favours short-term investments and maximises liquidity.

8. Financial Implications

8.1 The FSA registration requires the mutual to be able to access a capital fund sufficient to cover its prospective liabilities. The size of the fund will depend on the number of members, but it is anticipated that the initial fund will be in the region of £5-8 million.

8.2 Authorities that become full members will be required to provide a financial guarantee of up to £1million. The amount of the guarantee will need to be identified as a contingent liability in the accounts of the authority i.e. a note of potential future liabilities. There will only be a call on the guarantee from April 2008, if it is deemed necessary, i.e. only when Haringey has actually placed insurance business with the mutual. LAML will decide the basis on which authorities joining the mutual at a later time contribute their share to the on-going capitalisation requirements of the mutual and such basis will recognise the benefits to the mutual of the initial contributions.

8.3 The Financial Plan for LAML has used projections assuming a mutual commencing operations on 1st April 2007, with 6 members in 2007 and a further 2 members in 2008. The Financial Plan also assumes no further members are acquired and no members are lost during the first 5 years of operation. To date 11 authorities, including Haringey, are recommending membership of LAML to their members.

8.4 The Financial Plan assumes that LAML will be able to offer participating authorities a 15% 'up front' premium saving on those 2006 premiums which it is intended to offer cover on. At this time, it is proposed to offer cover on liability, property and motor vehicle insurance. Over the first five years, using the same assumptions and a retained surplus for members, the projected total saving for the authority is 20% over 2006 premium rates. This estimate has been derived mainly from LAML's ability to use its bulk purchasing requirements to purchase re-insurance policies in the market and the absence of any profit requirements put on LAML.

8.5 Haringey's current insurance arrangements are set out in Appendix A to this report, which describes the current levels of deductibles (policy excess) over each of the policies. The mutual will require the authority to maintain this level of deductibles. Over the first five years, the mutual will expect each member authority to move towards its minimum levels of deductibles for each policy if it does not already meet the requirements, namely: £100k for liability and property. No details of the deductibles required by LAML for its Motor Vehicle policy have been disclosed at present therefore it is not possible to state whether there will be any financial impact for Haringey.

8.6 Haringey already has LAML's minimum deductible level, or higher, for Education buildings and liability cover. However, the authority would need to increase its self insurance for 'general' buildings (excluding leasehold and commercial buildings) from £10k to £100k over the five years. This could have an additional financial cost over and above existing insurance fund resources, however, in theory this could be offset by a further reduction in premium levels. The table at Appendix A assumes that the 15% policy savings will be applied to the Motor Vehicle policy, but this has not yet been confirmed by LAML.

8.7 In addition, Haringey currently has in place 'stop-loss' insurance cover for liability and property, which is incorporated into our existing policies. This cover specifies the maximum costs which Haringey would be required to self-fund in any one financial year for certain polices. The insurance reserve has been established to take account of this. LAML is proposing to offer stop-loss cover, but at an additional cost. No costs for this cover have been provided by LAML for this to date, although it may impact on the 15% savings quoted as achievable by LAML if Haringey intended to purchase individual stop-loss policies. The Council's current stop-loss policies have not been breached in the last five years, but we would need to consider the risk closer to the time of placing business with the mutual.

8.8 Haringey currently employs a specialist claims handling company, in conjunction with our insurers, to assist in the management of all its insurance claims. The current contract requires Haringey to place a deposit of £102k per annum with the company. This figure is based on an estimated number of claims per year for each policy. If the number of claims falls below the estimate, Haringey will obtain a refund. Based on current claims experience, Haringey will obtain a refund for 2005/06 and 2006/07. The position with the mutual is that individual authorities should provide their own claims handling arrangements, but it is not clear yet whether our existing provider will work with the mutual. This may change nearer the time as details such as final policy wording becomes clearer. If in the event our existing claims handler does not wish to continue then we would need to seek alternative arrangements, which may have a financial impact.

8.9 In principle, the 'deductible' thresholds would remain, and the mutual would only carry risk above these levels. In addition, the mutual would reinsure the very highest level risks (for example, catastrophic risks where the claims involve very large sums of money) with a commercial insurer, after a procurement exercise, and this would benefit from the extra purchasing power of a larger group of local authorities. Therefore the mutual itself would only have to cover mid-range claims, above the deductible limits and below the level for reinsurance. These would be met from the premiums paid to the mutual and the capital held by it, or if that should prove insufficient, by further contributions from the participating authorities.

8.10 The maximum amount levied on a participating authority, in addition to the premium, in respect of any one financial year without a special resolution passed by the authorities at an annual or extraordinary general meeting is 50% of the premium paid by each authority in relation to that financial year. This right by the board of directors to raise additional premium income is considered to be a last resort. The intention is that the reinsurance protection afforded to the mutual covers the risk of adverse years, therefore this right is not one expected to be exercised in practice.

8.11 The mutual is not a standard procurement process and therefore the Council needs to be satisfied that value for money is being achieved. The financial model demonstrates value for money and estimates a 15% premium savings, however, this will only be completely certain when the mutual is operating. The Council's previous tendering process in April 2005 resulted in net savings of £200k p.a. so we know that we currently have competitive arrangements. The mutual will procure re-insurance cover through formal EU tendering and therefore this should ensure that maximum value for money is obtained.

8.12 In summary the potential saving is £220k based on the financial model, although a number of detailed issues are yet to be finalised as discussed above, which may impact on the level of this saving. Together with the knowledge that the Council produced financial savings at the last procurement in 2005, it would be prudent at this stage to not include a further saving in the budget plans at this point. If this is realised then this could count towards the approved target for Procurement.

9. Equalities Implications

9.1 There are no direct service delivery equality implications at this stage. When the plans and operational procedures for LAML are fully developed, the issues will be reconsidered to review any possible equalities implications.

10. Consultation

10.1 No consultation has been undertaken to date.

11. Conclusion

11.1 The establishment of LAML presents both risks and benefits for London Authorities. External legal advice obtained concludes that establishing and operating LAML would be within the powers of local authorities. FSA registration for LAML as an insurer is currently being sought and it is anticipated that this will be obtained by December 2006. Some of the issues raised in this report should be clarified by April 2007, the deadline for LAML to become operational. If members support the proposals, Haringey will ensure that we participate in the working groups to set up LAML to ensure that any detailed issues or concerns are raised and addressed appropriately.

11.2 At present, LAML proposals are still in draft format and there are areas which require further work and clarification. A summary of the main risks and benefits are listed in the table below.

Risks	Benefits
Not full certainty over costs. The model predicts savings that theoretically could be delivered.	The mutual will share 'best practice' experiences in claims handling and risk management across all members. Financial incentives to improve risk management and claims experience.
Predicted savings levels may not be achieved due to uncertainties, or may be absorbed or partly absorbed by other issues.	Improved purchasing power in the re-insurance market.
Additional financial commitments may be required if catastrophic losses occur (this would be the case without the mutual, but it can now be shared).	Financial risk will be spread over wider base of authorities and therefore this will smooth any significant impacts.
The detailed wording the policy cover documents may not reflect Haringey's current requirements, however the Council will be part of the working groups in formulating the standard wording for policies.	Policies applicable to the risks facing London authorities specifically, not the UK as a whole.
Potentially increased financial and personnel resource requirements to manage issues previously dealt with by insurance providers.	Any surpluses generated would be retained by and for the benefit of LAML's members.
	Not tied to small pool of insurance providers.
	Individual policy cover for each member depending on circumstances, claims history, risk management practices etc.

11.3 If LAML is successful, Haringey could benefit both financially and operationally in terms of economies of scale and improved risk management processes which would bring wider benefits to its residents.

12. Use of Appendices / Tables / Photographs

12.1 Appendix A – Summary of current insurance cover and LAML proposals

Appendix A

Summary of current insurance cover and LAML proposals

Policy	Current Insurer	2006/7 Premium £	Potential saving (15%) £	Deductible/Excess (each and every claim) £	LAML required excess £	Current Stop Loss Cover £
Liability (excluding tree root damage)	AIG	325,500	48,825	£150,000	**£100,000 minimum** Retain existing £150,000 excess	£3.5million per annum
Property	AIG	903,901	135,585	£100,000 Education buildings £10,000 other buildings (excl commercial/leasehold)	**£100,000 minimum** Retain existing excess for Education buildings ***Need to budget to increase 'other buildings' excess to £100,000***	£500,000 per annum – Education buildings only
Motor Vehicle	Zurich Municipal	240,485	36,072*	£250 Accidental Damage £1000 Theft	**Not specified**	
Total		**1,469,886**	**220,482**			

* Assumed 15% savings for Motor Vehicle Policy, although LAML documentation only specifies 15% savings will be achieved on Liability and Property policies