ITEM NO: 16

	Executive 13th November 2006 **Report from the Director of Finance and Corporate Resources**
For Action	Wards Affected: ALL
London Authorities Mutual Insurance	

Forward Plan Ref: F&CR 06/07-24

1.0 Summary

1.1 At the Executive meeting on 9th October a report entitled London Authorities Mutual Insurance and Procurement of Insurance Services was considered. The following recommendations were agreed:

1.1.1 The Executive agrees in principle to participate in the Mutual but subject to receiving a further report back from officers once they have fully explored this option and once external legal advice is obtained.

1.1.2 The Executive notes that the proposal is that the Council would become a full member of the company and would agree to purchase Brent's corporate Property, Liability and Motor insurance requirements for a minimum period of one year through the Mutual with effect from 1st April 2007. In the event that the Mutual is unable to assume risk by that date the Council would obtain interim cover through the tendering process described below.

1.1.3 The Executive further notes that the proposal also is that the Council would participate in capitalising the company by way of a financial guarantee of no more than £1m.

1.1.4 The Executive gives approval to officers to the inviting of tenders for insurance services as an alternative to joining the London Authorities Mutual on the basis of the pre-tender considerations set out in sections 3 – 5 of the report and gives approval to officers to evaluate tenders on the basis of the evaluation criteria set out in section 5 of the report.

1.2 This report gives further legal advice and sets out more information on the commercial terms.

1.3 As a result of this updated information the report recommends the Council participates in establishing London Authorities Mutual Limited as a full member.

2.0 Recommendations

The Executive:

2.1. agrees to participate in establishing London Authorities Mutual Limited as a mutual insurance company provided that the Borough Solicitor confirms that satisfactory amendments to its constitutional documents have been agreed as set out in the legal implications.

2.2. agrees to purchase its Corporate property, liability and motor insurance requirements for a minimum period of one year through the Mutual with effect from 1st April 2007 and authorises an exemption to the tendering requirements of the Council's contract standing orders for good operational and/or financial reasons as set out in paragraphs 3.1.2 – 3.1.6 and 4.1 – 4.3 of the report.

2.3. agrees that the Director of Finance and Corporate Resources be appointed as Brent's Member Representative and be empowered to represent the interests of Brent at general meetings of the Mutual and to vote on behalf of Brent.

2.4. agrees to participate in capitalising the company by way of a financial guarantee of no more than £1m and authorises the Director of Finance and Corporate Resources to take all necessary steps to achieve this.

2.5 notes the possibility of the Mutual not being operational in readiness to issue contracts for 1st April 2007, and that the Executive may receive a further report at its February meeting to award a contract for insurance following a tender exercise that will run in parallel with the start-up and registration of the Mutual.

3.0 Detail

3.1 <u>Introduction</u>

3.1.1 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).

3.1.2 This led to the proposal in the report on 9th October to the Executive for Brent to participate in the establishment of a "Mutual" insurance company controlled by, and run for the benefit of, participating London authorities. They would pool their risks and the costs of administration, whilst retaining the current levels of self-insurance. The Mutual will reinsure high-level risk and issue policies to its members annually. It will register with the Financial Services

Authority as an insurance company and it will need to capitalise (by guarantees from member authorities) and appoint experienced non-executive directors as well as London Finance Directors to ensure it was run appropriately.

3.1.3 A mutual offers advantages over and above reductions in annual premium. Underwriting profits are retained for the benefit of the members of the mutual, not paid away to third party shareholders. The financial incentives to make an underwriting profit enhance the value of and rewards the risk management endeavours of this authority. A mutual offers the opportunity to determine underwriting appetite and develop policies which are focused solely on and meet the needs of local government in London. A mutual structure offers the prospect of greater pricing stability and will attract support from sectors of the reinsurance industry who would not entertain individual local authorities. A collaborative endeavour across London Boroughs links in with the agenda to maximise cost efficiencies and with the National Procurement Strategy of collaborating in the purchase of services. Other groups of authorities in the country are also considering establishing similar vehicles.

3.1.4 Brent currently insures the bulk of its policies with Zurich Municipal. Previously the Council insured with Royal Sun Alliance. The total annual cost of premiums in 2006/07 was £1,211k. This contract was competitively tendered and the service began on 1st April 2002. Only two full tenders were received in that exercise reflecting the weakness of the local authority market.

3.1.5 The current insurance arrangements are a mixture of retained losses (self insurance) and external insurance coverage. The program has three elements of cover comprising of property, liability and other risks primarily motor insurance. The essential difference in the covers is that property and liability carry significant excesses and losses under the excess level are retained (self insured). Motor and all the other miscellaneous covers have very small excesses and all the risk is placed in the insurance market. The current levels of excess applying to the property and liability covers is £278k and there is an aggregate stop loss protection of £3,481k. The effect of the aggregate stop loss protection is that the cover applies to all losses sustained in any one year up to the stop loss level. Losses in excess of this figure are then fully insured and this provides protection by way of a known ceiling of possible expenditure in any financial year. This configuration has been in place since 1994.

3.1.6 In the period since 1994 there has only been one recovery from Zurich Municipal and that was in respect of the fire damage sustained by Willesden High School in 2000. The amount of the recovery was £383k which is the total of the loss in excess of the retained loss figure of £250k in force at the time. Brent has thus been paying significant premiums since 1994 and only recovered monies on one claim.

3.2 <u>The form of Mutual</u>

3.2.1 A mutual called “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 FSA registration has been completed.

3.2.2 LAML is a company limited by guarantee. London authorities that wish to take part in the Mutual will become full members. They will have equal voting rights. They 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.

3.2.3 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.

3.2.4 A minority of directors (initially two) will be independent directors. This is a requirement of the FSA and of the Code of Governance for mutuals of this kind. The non-executive directors will have experience of the insurance industry. They will be paid for performing that role, but the local authority nominee directors will only receive their reasonable incidental expenses.

3.3 <u>Capitalisation</u>

3.3.1 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 not exceed £5 million***.***

3.3.2 Authorities which become full members will be required to provide a financial guarantee of no more than £1m. It is believed from advice taken that the amount of the guarantee will not need to be provided for in the accounts of the authority. It would be regarded as a contingent liability with a note to the Council’s annual accounts explaining this. 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.

4.0 Financial Implications

4.1 The premium payment to Zurich in 2006/07 for the coverage that will be provided by the Mutual is £932k. A minimum saving of 15% of this sum will accrue in 2007/08 under the terms of the Mutual. This amounts to £140k and the financial modelling assumes this will also occur in future years. This reduction can be utilised within the 2007/08 budget and beyond to fund priority growth, as agreed in the Corporate Strategy, or reduce overall expenditure and hence the level of Council Tax. It is hoped and expected that as underwriting profits are retained for the benefit of Members through lower premiums the savings will increase. This arrangement will therefore be of general benefit to Brent residents and link to the key objectives in the Community Strategy.

4.2 The Council would also seek to gain from improving its risk management, with support from the Mutual. This will not only lessen the financial risk to the Mutual, but also help to reduce payments out of the Council's self insurance Fund.

4.3 The terms offered to the Council for excess levels and aggregate stop loss remain as those currently available (see paragraph 3.1.5).

4.4 In the report to the October Executive the latest financial modelling undertaken by CTC to test the financial viability of the Mutual was presented. This has now been updated to include only those authorities which have indicated they are likely to join the Mutual in the first 15 months of operation from 1st April 2007 to 30th June 2008. This reflects the different end dates for present longterm insurance contracts ending. 12 authorities are currently seeking decisions from their Executives to join the Mutual. These are Brent, Camden, Croydon, Hammersmith and Fulham, Harrow, Haringey, Havering, Islington, Kingston, Lambeth, Redbridge and Tower Hamlets. A number of other authorities have contract end date further into the future and will make a decision on whether to join the Mutual later.

4.5 The results of this latest financial modelling indicate that LAML remain a viable option for the proposed membership pool. It also estimates to deliver the up-front rate saving of 15% as well as a potential surplus of £1.6m over 5 years.

4.6 These projections are based on the claims history of each authority. The model is based around 4 loss scenarios:

- Expected Loss scenario – this is the expected loss scenario based on the actual loss history of the participating authorities – 5 years for Property and 10 years for Liability.
- Good Loss scenario – this is a loss scenario which is better than the historic loss experience and could be achieved as risk management standards and practices are aligned and continue to improve.
- Poor Loss scenario – this is a loss scenario which is worse than has been experienced over the last few years by the participating authorities. This scenario may represent an unfortunate run of school fires or a higher than anticipated occurrence of large Liability claims.
- Catastrophic Loss scenario – this is a loss scenario where a serious event or a series of serious events hits the participating authorities. In this scenario there could be a serious Terrorist incident or incidents, a Thames flood and/or a serious wind/rain storm.

4.7 The Mutual will purchase re-insurance to cover against both the Poor and Catastrophic Loss scenarios. This significantly reduces the financial risk to the Mutual and hence its members of needing to make additional contributions. The cost of this re-insurance will not be established until after a tendering exercise. However, CTC believe that there is a buoyant market and prices will be well within latest estimates.

4.8 The Council has sought independent advice on the assumptions and results within the models. PwC, our external auditors, have a specialist insurance section within their firm and provided this support. The key issue highlighted is assessing what the potential downside could be for Brent and whether or not this represents an acceptable level of risk. This financial downside would be generated in circumstances where after a number of *"poor"* years the price of re-insurance had risen, to reflect the Mutual's claims history to a level which would require the members to put in extra resources. This also is a similar risk in our current arrangements and the Council has the option of leaving the Mutual with 12 months notice which will provide a significant element of flexibility. An extensive risk assessment was included in the last report covering a range of other issues.

4.9 It has been agreed that the initial financial year of the Mutual will run for 15 months. This will allow the operational costs to be spread across a maximum number of participants. This is an advantage for Brent as we will be one of the first entrants.

4.10 The Council also incurs additional external administrative costs in running the insurance service. These are brokers' fee of £5k, claims handling fee of £55k and legal fees of £80k. These are initially anticipated to be at around the same level in 2007/08 although administrative arrangements will need to be amended to reflect the new circumstances of the Mutual.

4.11 The cost of the tendering exercise will be met from existing resources. Much of the work planned to be undertaken would be required if the Council were to join the Mutual.

5.0 Exemption to Standing Orders

5.1 The Council's Contract Standing Orders require a tendering exercise for contracts of this size unless there are good operational and/or financial reasons for not doing so. These are set out in sections 3 and 4 of the report.

6.0 Legal Implications

6.1 The external legal advice referred to at the October Executive meeting has now been obtained in the form of two Counsel's Opinion. One Opinion was from Nigel Giffin QC, on the subject of local authority powers to participate in the Mutual and the application of the EU Public Procurement rules, while the other was from Stephen Kenny QC, who specialises in insurance.

6.2 The advice from Stephen Kenny identified nothing of major concern in the Mutual's constitutional documents. He had one specific concern about the fact that the rules of the Mutual appear to permit it to act as a "front" insurer when arranging special insurance for individual members. While it would be acceptable for the Mutual to arrange cover for individual members as an intermediary or broker, acting as an insurer for specialist cover (even if 100% re-insured) could expose the Mutual to unnecessary risk in the event of a failure of the reinsurance arrangements. It is therefore proposed to make representations to Croydon as lead borough on this project to seek an amendment to this part of the Rules, and the result of these representations can be reported to Members orally at the meeting.

6.3 Nigel Giffin identified two separate legal powers as authorising participation in the Mutual. The first is section 111 of the Local Government Act 1972, which empowers a local authority to do any thing "which is calculated to facilitate, or is conducive or incidental to, the discharge of any of" its functions. Counsel considers that this power is firstly available to permit the arrangement of insurance against losses and liabilities arising in the discharge of any local authority function, using a conventional insurer. He then concludes that section 111 also permits insurance through a mutual.

6.4 Nigel Giffin did however see a counter-argument that section 111 could not be used to authorise participation in the Mutual, on the basis that participation involves taking on financial obligations in respect of risks arising from the functions of other local authorities. However he concluded that this was part and parcel of the overall set up of the Mutual, and in accordance with other areas of legislation (e.g. section 101 of the 1972 Act) empowering local authorities to discharge functions jointly, provided that the Mutual was limited to participation by London local authorities.

6.5 Counsel did then advise that the proposal to allow "affiliates" of member local authorities to participate in the Mutual should be restricted. This term is defined in the constitutional documents as “any legal entity associated with any Member” but Brent has been advised that this is to allow ALMOs and voluntary aided schools etc to participate, as some authorities arrange insurance for such bodies. Affiliates will not have membership rights but can be insured through a Member. Again, it is proposed to contact Croydon and make representations that "affiliates" should be given a narrower definition.

6.6 The second power identified is section 2 of the Local Government Act 2000, otherwise known as the well-being power. It allows a local authority to do any thing which the authority considers is likely to achieve the promotion of improvement of the economic, social or environmental well-being of its area. It is a very widely stated power. Clearly insuring against liability does not in itself promote or further well-being, but as it is hoped there will be around 15% savings in premiums, there will arguably be indirect promotion of well-being in the form of additional resources available for existing or new services. Paragraph 4.1 above indicates how indirect benefit will accrue to residents.

6.7 In conclusion the Nigel Giffin considered that section 111 was a better power to rely on than the well-being power, but that both could be relied upon (though not clear cut). In relying on the well-being power, the legislation states that it is necessary to have regard to government guidance on the exercise of the well-being power, and to Brent's own community strategy. In relation to the guidance, it is noted that this refers to the power as “encouraging innovation" and also refers to the well-being power being used to allow the establishment of companies. There is nothing else in the guidance that renders doubtful reliance on this power. In relation to the community strategy, while the proposed Mutual does not specifically link in with any Key Objective, it does not undermine or contradict any part of it.

6.8 Nigel Giffin also considered the issue of European public procurement law. Insurance services contracts are required by the Public Contracts Regulations 2006 to be awarded only after a tender process that is compliant with the Regulations. Legal advice had already been obtained by the lead borough that an exemption is available. This exemption is known as the "in-house company exemption", or the "*Teckal*" exemption after the case in which it was first identified. It has been accepted for some time that in-house provision by the contracting authority itself does not give rise to "a contract" under the EU public procurement rules. The *Teckal* exemption recognised that this could be extended to the situation where it is proposed to award a contract to a closely connected but separate legal entity, but only where two conditions applied:

- firstly, the procuring authority must exercise over the supplier "a control similar to that which it exercises over its own departments";
- secondly, the supplier must carry out "the essential part of its activities with the controlling local authority or authorities".

6.9 The constitutional documents show that the second condition will almost definitely be met, as the Mutual will only exist to provide insurance for its members (and possibly their affiliates - see above). However the first condition is more problematic due to the fact that there will be more than one authority. In addition recent case law shows that the *Teckal* exemption is to be restrictively interpreted, and that in some cases the exemption could not be relied upon because the members did not have sufficient control over the decision-making of the Board of Directors. Nigel Giffin concluded that there was the ability to rely on the *Teckal* exemption to allow direct award to the Mutual without tendering, but that this ability would be strengthened by amendments to the constitutional documents to require the Directors to act in accordance with a resolution of the members. Again, representations on this will be made to the lead borough and an oral update provided to Members.

6.10 Members will appreciate that the advice received, though confirming that participation in the Mutual is lawful, sees room for doubt both in relation to legal powers and in relation to the availability of the *Teckal* exemption. There is therefore possibility of challenge from any aggrieved party, although this risk is considered low because the law is basically sound, and because the only likely challengers are insurance companies who will lose out on London local authority business. Such insurance companies will probably be interested in tendering for reinsurance contracts from the Mutual so are unlikely to challenge. In relation to both a challenge under the EU procurement rules and a challenge by way of judicial review for illegality / unreasonableness, a complainant needs to act quickly, though for the former it is not until the award of contract from 1st April 2007 that time starts running.

6.11 The consequence of a successful challenge on the grounds of lack of statutory powers depends upon whether Brent's insurance contracts are also held to be unlawful. Stephen Kenny advised that if the insurance contracts themselves were declared unlawful by a court then the whole arrangement would have to be unravelled, with premiums being repaid to members, but also members who had made a claim having to repay what they had received. The Council would also be in the position of having had no compulsory road traffic and employers liability cover for the period it had been with the Mutual, and so potentially subject to penalties under the relevant acts.

6.12 A contract of this value (in excess of £1m per year) is categorised as a High Value contract under Contract Standing Orders and so is required under paragraph 84 (e) of Contract Standing Orders to be subject to a formal tender process. However the Executive can grant an exemption to this requirement where it considers that there are good operational and / or financial reasons for doing so (paragraph 84(a)). Such reasons are put forward in the report.

7.0 Next steps

7.1 The next meeting of the Steering Group will be held on 3rd November and the Director of Finance and Corporate Resources will update the Executive of any significant developments.

7.2 FSA registration as an insurer is being sought. The FSA have indicated they will make that decision including the level of capitalisation required before the end of December.

7.3 The initial directors will formally establish the company as a Mutual and appoint independent directors.

7.4 The company will formally procure the appointment of pool providers and reinsurance. If necessary, CTC's engagement will be extended for a transitional period pending the appointment. CTC will not, however, be involved in the procurement of pool providers, which will be undertaken on behalf of LAML by a lead authority as agreed by the directors of LAML.

7.5 It is expected that these formalities can be completed in time for LAML to issue policies from 1st April 2007.

7.6 In the event that LAML cannot issue policies until 1st April 2008 because of some unforeseen delay, Members have agreed an alternative strategy to tender its coverage as agreed by the Executive on 9th October. This process will continue to ensure appropriate insurance coverage is in place from 1st April 2007.

8.0 Diversity Implications

8.1 The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

9.0 Staffing/Accommodation Implications (if appropriate)

9.1 All options in the report are likely to lead to a change in working practice for those involved in insurance work.

10.0 Background Papers

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
9. Advice from Nigel Giffin QC on Legal powers and procurement
10. Advice from Stephen Kenny QC on Insurance issues
11. General fine on Insurance Mutual
12. Report to Executive 9th October 2006, London Authorities Mutual Insurance and Procurement of Insurance Services

11.0 Contact Officers

11.1 Duncan McLeod, Director of Finance and Corporate Resources , Room 114b, Brent Town Hall, Forty Lane, Wembley, Middlesex HA9 9HD. Tel. 020 8937 1424.

DUNCAN McLEOD
Director of Finance and Corporate Resources