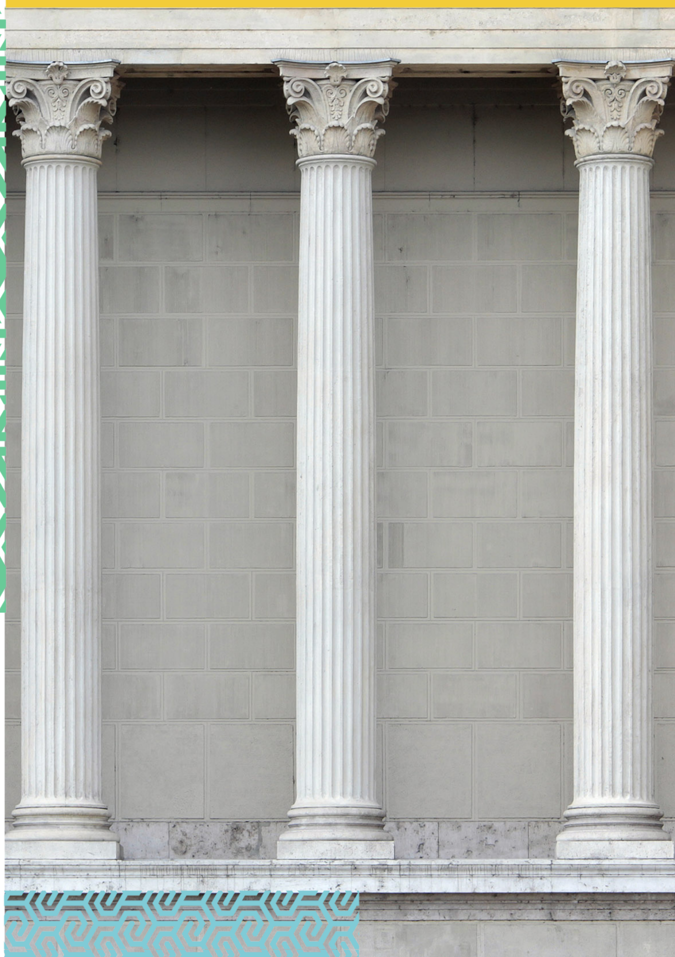
Broker Bulletin No. 6 – LGA Mutual Proposal



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Since the Local Government Association (LGA) made its announcement in the Local Government Chronicle (July 2017)[1], of its intention to consider setting up a mutual, we have been asked by brokers and clients to provide our thoughts and comments on the conceptt.

The purpose of this briefing therefore is to outline our views and make a useful contribution to the ongoing discussion.

1 At this stage there is little or no information in the public domain around the mutual structure or how it will operate and therefore it is impossible to comment upon the viability of the proposal. What we would suggest is any Local Authority considering the mutual do so on the most informed basis they can and to have a thorough understanding of:

a. The cover to be provided and the basis of that cover.

b. The financial feasibility of the mutual and how much relevant claims information has been factored in.
The public liability profile of the public sector is one of long tail claims (IBNR (Incurred But Not Reported) /IBNER (Incurred But Not Enough Reserved)) which are often reported many years after the event giving rise to the claim.

c. The rules for joining and leaving the mutual – do they allow freedom for a member to fix its risk transfer programme in the best way to suit them at that point in time, or is a significant period of notice required before the member can leave the mutual?

d. What will be the legal structure of the mutual – will it be a discretionary mutual or a different structure? What would happen to the run off claims (which could still be reported for 30 years plus) in the event of the mutual closing and could there be a financial call made on members to fund the long tail claims of the future?

e. RMP and other market participants have long referred to the Total Cost of Risk (TCoR) – the concept that when looking at risk an organisation should look beyond the immediate costs of the premium but factor in other elements of the risk transfer programme including the cost of claims. We will all have our own views on what should and should not be included within the TCoR model but for the purposes of this briefing let's consider this to include:

— Premium

— Insurance Premium Tax (IPT)

— Cost of claims within the self-insured layer

— Overall cost of the claims handling function

The only parts of the risk which a mutual could directly influence are the premium which in turn affects the IPT payment. The cost of the claims is the cost of the claims and only risk management and investment by the insured will directly affect this.

Further the premium is currently subject to the rigors of a formal tender process once every 3 or 5 years where each bidder does everything they can, and within the closed tender environment, to offer as competitive a premium as possible and also offer the best cover and most enhanced service that meets the tendering authority's requirements.

One of the key elements to the tender process is that even if only one insurer quotes the risk, they do not know they will be the only insurer to quote at the time of formulating their pricing and tender offer, and hence in all probability will still offer the best price and cover they feel applicable for the risk.

2 RMP has long been an advocate of competition within the market and over the years have done as much as anybody to bring new insurers to the public sector insurance market place. At our core we believe competition drives up quality of cover and service, creating innovation, whilst at the same time checks the desire of any insurer, (even if they wanted to), to generate unhealthy returns.

The recent new entrants into the market have only further strengthened the position of the market and thus in 2017 we find ourselves with a vibrant, competitive market, with a number of insurers all competing for the risks, ironically at a time when the profile for large catastrophic claims has never been greater.

3 Not just RMP but all insurers and brokers offer a range of services which may come as part of the programme, including risk management, claims management, underwriting guidance, support and training to name but a few areas. These insurer/broker skills have been honed over a great many years of dealing with risks and in particular those of the public sector. How would a mutual look to replicate this?

4 It is through the examination of collective losses and assessment of risk that organisations can make the most informed decisions over understanding risk, how it may be best managed and sharing best practice. Insurers probably undertake this role better than anyone and in turn help to drive down risk and the overall costs of claims to the benefit of all policyholders. It is the need to remain competitive in a challenging environment that does not allow insurers to rest on their laurels but to continually seek to improve the quality of the risk underwritten.

[1] ..\2018\Digest LGA plans cash saving insurance mutual News Local Government Chronicle.pdf

5 On more than one occasion insurers have defended claims through the courts if it was felt that legally challenging the claim best represented the interests of all local authorities and it was important to set a precedent around how such claims maybe viewed in the future. Would a mutual have the same long term commitment to the sector?

Our aim in making the above points is really to ask customers to consider any alternative risk financing proposals within the context of the current public sector market, the journey of the market since 1992, the propensity for large claims, and how the real savings to any programme over the long term rest within the self-insured retained layers of the programme.

The LGA article makes a number of claims which we would encourage any Local Authority considering the proposal to examine in greater detail and should be substantiated:

(i) The article implies the mutual will save money – ("…*setting up a mutual to save councils money on their insurance bills and improve cove*r"). How?

(ii) *"Councils currently spend £650m a year on insurance"* – how is this known and how is this figure broken down? Does it include IPT? Should we also not examine how much Councils spend from their own funds on paying claims within the self-insured retention? How much do insurers pay out typically in any one year? Is it greater than £650m and what impact will the recent change in the discount rate have on this figure?

(iii) *"The association is hoping to emulate the Fire & Rescue Indemnity Company which was set up in 2015 by nine fire authorities and achieved a surplus of nearly £500,000 in its first year of trading, equivalent to 12.5% of contributions"*. Does this statement reflect allowance for IBNR and IBNER and how are catastrophic claims funded within the model? What impact, if any, does the change in the discount rate have on this?

(iv) *"Mutuals are long-established and trusted"*. What evidence is there to substantiate this statement in relation to this market? The main mutual (MMI) went into a scheme of arrangement at a time when it held around 95% market share and has since gone on to make a call/claw back on members for additional funds.

(v) *"A local government mutual would save councils money and give members the chance to control and manage their risks, claims and cover more effectively"* How do we know this until the product was subject to market testing? Councils always have been in control of their risks and claims.

(vi) *"In 2014 the LGA set up Public Sector Audit Appointments Ltd to run a national procurement to appoint auditors. The results of the procurement, which covered 484 of493 eligible bodies, were announced last month and PSSA said it had saved the sector £6m on audit bills, equivalent to an 18% reduction in fees".* – In our view the procurement of insurance and the risk transfer process is fundamentally so different to a national procurement process to appoint auditors that to draw similarities is very difficult.

RMP continues to seek out new and innovative ways of managing risk, from the process of risk transfer to the guidance and sharing of best practice around the management of risk itself but we also welcome the increased focus on the public sector market that the mutual proposal has generated.

Competition is healthy, as it can only make us all collectively better in the long run and offer customers a greater variety of choice. As such we look forward to learning more about the new mutual proposal, understanding its feasibility, offer of cover, structure and proposition, so that the detail can be better absorbed and understood.

Further information

For access to further RMP Resources you may find helpful in reducing your organisation's cost of risk, please access the RMP Resources or RMP Articles pages on our website. To join the debate follow us on our LinkedIn page.

Get in touch

For more information, please contact your RMP consultant or account director.

contact@rmpartners.co.uk

Risk Management Partners

The Walbrook Building
25 Walbrook
London EC4N 8AW

020 7204 1800
rmpartners.co.uk

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