Buckinghamshire & Milton Keynes Fire Authority

MEETING	Fire Authority
DATE OF MEETING	12 December 2018
OFFICER	Mark Hemming, Director of Finance and Assets
LEAD MEMBER	Councillor Peter McDonald
SUBJECT OF THE REPORT	**Insurance Arrangements from 2019/20**
EXECUTIVE SUMMARY	This paper presents to Members the proposal for the Authority to join the Fire and Rescue Indemnity Company (**FRIC**), a private company limited by guarantee formed by other Fire and Rescue Authorities (FRAs) to act as a pool for insurance purposes from 1 April 2019. The Authority purchases insurance cover in order to meet statutory requirements and to mitigate risk. This has been arranged in the past by tendering for the services via an EU compliant process. The current three year long term agreement expires on 31 March 2019 (with an option to extend for a further two years if required). Following an options appraisal it is proposed that the Authority adopt a collaborative approach by joining the FRIC. Under the pooling arrangements all the participating fire and rescue authorities would share financially with each other, on a proportionate basis, the cost of establishing a pool fund from which any loss incurred by an individual member of the insurance pool would be met. This arrangement was first established by nine fire and rescue authorities in 2015. Full details are set out in **Annex A**. The FRIC has issued a 'Prospective Member Guidance' which is attached as **Annex B**.
ACTION	Decision.
RECOMMENDATIONS	It is recommended that : 1. the Authority's participation in the pooling arrangement and that the Authority becomes a member of the Company (providing a guarantee of £100) be approved; 2. the Authority's participation in the pooling arrangement for its corporate property, liability, motor and other miscellaneous insurance requirements for a minimum period of three years through FRIC with

	effect from 1 April 2019 be approved; 3. participation in a financial guarantee for supplementary premiums should claims against the pool exceed the funding available be approved; 4. the Director of Finance and Assets be appointed as the Authority's representative to: a) receive statutory and other notices and documents from the FRIC, b) communicate with and give instruction to the FRIC on the Authority's behalf, and c) provide a receipt for payments which may be made by the FRIC to the Authority; 5. the Director of Finance and Assets be appointed as the Authority's voting representative at FRIC general meetings or otherwise and to exercise the Authority's right to attend and be heard at any FRIC general meeting; and 6. an exemption from Standing Order 8 of Standing Orders Relating to Contracts (Competitive Tendering Process) be granted
RISK MANAGEMENT	There are a number of related benefits which should result from the Pool arrangement but, essentially, the arrangement should be significantly more cost-effective than "ordinary" insurance. The costs benefits result from the following: (a) the Pool will not be profit-making and so the cost of each FRA's contributions should be lower than the cost of premia paid to external insurers to obtain the same cover, since there is no need to build in a profit element; (b) the costs of insurance on the open market have been high in recent years, because only a few insurers are interested in the "blue light" market and because there have been significant claims that have led to a rise in premiums; (c) the insurance for large single losses ought to be cheaper if it is bought collectively by multiple authorities than if it were bought separately by each FRA; (d) the Pool arrangement will provide an incentive to FRAs to make use of best practice to minimise their risks, because the fewer the claims, the less expensive the calls to contribute should be; and (e) the Hybrid Discretionary Mutual arrangement is considered to be capital efficient. There are, however, risks involved in entering into the Pool arrangement. The main risk is that if there were an unexpectedly large number of claims upon the funds in the Pool, it would be necessary for the participating authorities to top up the Pool by committing additional funds to it. The commercial risks of the arrangement will rest with the FRAs, rather than with private sector insurers.

	Provision for supplementary calls will, therefore, be included in the pooling arrangement. The FRIC anticipates that the risk of the costs of claims exceeding contributions will be greatest in the early years of the arrangement. A member may not withdraw from the FRIC except at the expiry of a protection period or with the written consent of the FRIC. A member which ceases to be a member for any reason shall be and remain liable to pay all contributions owing by it, save for contributions due in respect of an indemnity year which has been closed.
FINANCIAL IMPLICATIONS	The total insurance premium payable for 2018-19 was £356k, against a budget of £327k for the year. The indicative premium payable to the FRIC for 2019-20 is between £270k and £300k. The exact fee will be confirmed during the due diligence process. There is a one-off charge of £15k payable for on-boarding and a one-off fee of around £3k will be payable for the validation of risk management arrangements (depending on the level of support needed to document the arrangements).
LEGAL IMPLICATIONS	**Vires** The FRIC received Leading Counsel's Opinion in April 2014 which has been shared with officers (a copy can be provided to members of the Authority on request). Leading Counsel confirmed that fire and rescue authorities can enter into the insurance pooling arrangements using the discretionary powers granted to them by the introduction of section 5A of the Fire and Rescue Services Act 2004 on 18 February 2012. Section 5A provides that the Authority may do: • anything it considers appropriate for the purposes of the carrying-out of any of its functions (its "functional purposes"), • anything it considers appropriate for purposes incidental to its functional purposes, • anything it considers appropriate for purposes indirectly incidental to its functional purposes through any number of removes, • anything it considers to be connected with— – (i) any of its functions, or – (ii) anything it may do under paragraph (a), (b) or (c), and • for a commercial purpose anything which it may do under any of paragraphs (a) to (d) otherwise than for a commercial purpose. Therefore, the Authority has the vires to become a

	member of a company and to make payments to that company for the purposes of providing mutual insurance cover. **Public Contracts Regulations 2015 (PCR)** The FRIC received a further and separate Leading Counsel's Opinion in May 2015 as to whether participating FRAs can obtain insurance services from a company limited by guarantee, without going out to tender under the procurement rules set out in the PCR (a copy can be provided to members of the Authority on request). Regulations 12(5) and (6) of the PCR provide an exemption for FRAs so that they can contract with the FRIC direct without undertaking a public procurement exercise if all of the following criteria are met: 1 The decision-making bodies of the FRIC are composed of representatives of all participating FRAs; 2 The participating FRAs are able to jointly exert decisive influence over the strategic objectives and significant decisions of the FRIC; and 3 The FRIC does not pursue any interests which are contrary to those of the controlling FRAS. The Opinion provided guidance to the FRIC in order for it to structure its Articles of Association to comply with those criteria. **Contract Standing Orders** Contract Standing Order 4 permits the Authority to grant an exemption to enable a contract to be placed by direct negotiation with suppliers rather than in accordance with Standing Order 8 (Competitive Tendering Process) provided that this remains compatible with English and EU law.
CONSISTENCY WITH THE PRINCIPLES OF THE DUTY TO COLLABORATE	Eligibility to join the FRIC is restricted to fire and rescue authorities. Over the years, third party insurance has been very costly with very little competition in the fire sector. This alternative was researched and the FRIC was subsequently set up for the mutual management of risk, to provide discretionary cover and the purchase of external insurances. It is owned and controlled by the member fire and rescue authorities. In its first two years FRIC has delivered a surplus of £607k, equivalent to 8% of the contributions from each Member Authority. This is money that would otherwise have gone out of the public sector, instead it can be retained to support further improvements and drive better risk management and ultimately, deliver lower costs for FRIC's members. The key to long-term savings in risk protection costs is

	the active management of risks and the development of best practice in this area. To support this, FRIC established and supports the Fire and Rescue Risk Group (**FARRG**). This Group is open to any authority to join who are looking to work collaboratively to improve its claims experience with no obligation to join FRIC but who are willing to share its knowledge and experiences, and prepared to work collaboratively to develop improved risk controls and reduce claims. This Group looks to develop mutually agreed policies and procedures, and provide funded access to joint training, risk management products and expertise.
HEALTH AND SAFETY	FRIC established and supports the FARRG, which looks to develop mutually agreed policies and procedures, and provide funded access to joint training, risk management products and expertise, all of which will have a positive impact on Health and Safety.
EQUALITY AND DIVERSITY	No direct impact.
USE OF RESOURCES	See Financial Implications.
PROVENANCE SECTION & BACKGROUND PAPERS	**Background** Insurance Arrangements from 2015/16, Executive Committee, 18 March 2015: https://bucksfire.gov.uk/files/6814/2564/4308/ITEM_12_Insurance_Renewal_2015-16_Exec.pdf Insurance Arrangements Update, Executive Committee, 13 July 2016: https://bucksfire.gov.uk/files/2714/6762/7021/ITEM_9_Insurance_Arragements_Update_-Rev.pdf FRIC Ltd Company Rules November 2015 FRIC Ltd Articles of Association 1 December 2017 (link to Articles submitted to Companies House) Standing Orders Relating to Contracts, approved October 2017: https://bucksfire.gov.uk/files/6015/0894/3533/Contract_Standing_Orders_-_October_2017.pdf
APPENDICES	Annex A – Insurance Arrangements from 2019/20 Annex B – ‘Prospective Member Guidance’ FRIC Ltd.
TIME REQUIRED	15 minutes
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Annex A – Insurance Arrangements from 2019/20

1. Introduction

1.1. The Authority has a statutory requirement to put in place certain insurances and also uses insurance to mitigate a range of risks. Historically the Authority has purchased its insurance cover from the open market.

1.2. Alternative models for insurance have been proposed in the past as the local government sector has sought to address limited competition in the insurance market and concerns about premium levels. There is now an established alternative model with a fire specific focus and this report recommends that the Authority adopts that model.

1.3. The Fire and Rescue Indemnity Company (**FRIC**) is an entity formed by other fire and rescue authorities, to act as a pool for insurance purposes. Under the pooling arrangements all the participating fire and rescue authorities would share financially with each other, on a proportionate basis, the cost of establishing a pool fund from which any loss incurred by an individual member of the insurance pool would be met. It is owned and controlled by the member Fire and Rescue Authorities, currently Bedfordshire, Royal Berkshire, Cambridgeshire, Cheshire, Devon and Somerset, Leicestershire, Kent, Hampshire and Essex all of which were the nine founding members. East Sussex resolved at its meeting on 6 September 2018 to apply to become a member commencing 1 April 2019, the first joining member since FRIC was incorporated. Losses above the pool's threshold are covered by insurance cover purchased by FRIC.

1.4. The Company was set up to provide an alternative to traditional insurance and give member fire and rescue authorities greater control over the cover provided and the management and settlement of claims.

1.5. FRIC has been trading since November 2015. The first two years published financial results are summarised below and demonstrate a sound level of performance in line with that originally modelled:

	2015/16	**2016/17**
Contributions	£3,774k	£3,803k
Surplus	£471k	£136k
Expense Ratio*	17.5%	19.2%
Combined Ratio**	87.5%	96.4%

* The expense ratio in the insurance industry is a measure of profitability calculated by dividing the expenses associated with acquiring, underwriting and servicing premiums by the net premiums earned by the insurance company.

** A measure of financial year underwriting profitability. It is the sum of the net claims, commissions and expenses divided by net earned premium. This excludes instalment and other operating income, and investment return. A combined operating ratio ("COR") of less than 100% indicates profitable underwriting.

2. Key Benefits

2.1. Cover is provided via a mutual arrangement, the structure of this arrangement means contributions are paid in to a 'pot' based in the individual risks and historic claims profile. It also takes into account the need for a variety of member deductibles depending on risk appetite and financial strength of the authority.

2.2. Although the FRIC is owned by the authorities the pool is managed by Regis Mutual Management a private company based in London. Regis was selected through a competitive process and is experienced in providing a fully integrated and comprehensive services dedicated to developing mutuals in the public sector. Regis' in-house claims staff provide a claims handling service, assisting member authorities with any claims.

2.3. The hybrid discretionary mutual model means Insurance Premium Tax (**IPT**) is only due on the Protection Programme premiums that are paid to external insurers by FRIC on its and its members behalf. The IPT paid by the Authority as part of its premia for 2018/19 was £38k.

2.4. With its sector specific focus, over the life of FRIC it has developed a risk management assessment process. To support this FRIC established and supports the Fire and Rescue Risk Group (**FARRG**). As a result the process is more specifically suited to fire and rescue and the collaborative learning from FARRG's co-ordinated activity should over time help to reduce the frequency and severity of claims, not only saving FRIC cash but the Member's operational and management time associated with each incident and related reputational impact. This Authority has been a regularly participant in the FARRG for the past two years.

2.5. The nine Authorities have worked together over the past five years to develop a risk management assessment process and to share best practice, including the benchmarking of risk management arrangements against best practice and a commitment to work to meet this standard. In addition FRIC, through a contract with Regis Mutual Management, provide some risk management support.

3. Scope of Cover

3.1. While FRIC provides all the key covers, officers have identified that engineering inspections and legal protection (against uninsured drivers) that the Authority currently has are not provided through FRIC. The current cost of these is estimated at circa £6k per annum.

3.2. The Authority will have the option to purchase the non-mutual elements either directly from the market, from a national framework or through FRIC's solution which is expected to be in place 1 November 2018.

3.3. There will be an evaluation of policy wording to ensure that the covers offered by FRIC are comparable to those currently in place. This will be carried out as part of the "on-boarding" process.

3.4. The discretionary element is a legal device to ensure that the arrangement is not treated as insurance and there have been a number of legal judgements confirming this view. It does mean that the Authority would have no absolute guarantee that any particular claim would be paid, however such decisions would rest with the Directors of the pool who would have the power to agree to meet any claim made. In practice, there is a similar risk with an insured arrangement if the precise terms and conditions of the insurance contract are not met. Also in practice, the basis of the pooling arrangement is one of mutual trust, and if a claim was not met then there is a risk that the pool could collapse.

3.5. Directors of the company are appointed by the participating authorities; no single authority has the right to appoint a director. As with the mutual insurance company it is proposed that these are drawn from appropriate professionals within participating fire and rescue authorities' supplemented by one or two experienced insurance industry figures. The day to day management of the pool is undertaken by a professional management company, Regis Mutual Management Limited, which is required to meet all the necessary professional requirements of the Financial Conduct Authority.

4. Financial Assessment

4.1. The Authority's current agreement for the provision of insurance comes to an end on 31 March 2019. It was let through a competitive process and cover is provided by Zurich Municipal. The total cost of insurance premiums for 2018/19 is £355,700 including Insurance Premium Tax (IPT) at 12%. This is an increase of 10% on the previous year (including a 2% increase in IPT).

4.2. Details of the Authority's claims history and various measures and metrics commonly employed within the insurance industry were provided to FRIC and they were able to provide indicative prices. This allowed officers to conduct an initial evaluation. The indicative price provided by FRIC is between £270k and £300k, compared to the premium paid in 2018/19 of £356k. The anticipated saving is therefore between £50k and £80k per annum (once additional covers not provided by the FRIC are taken into account – see paragraph 3.1).

4.3. There is a one-off on-boarding fee of £15k payable as part of the process of joining FRIC to cover the legal and other expenses and a one-off fee of around £3k will be payable for the validation of risk management arrangements (depending on the level of support needed to document the arrangements).

4.4. The Authority's current level of deductibles is £5,000, which is the same as the minimum level set by FRIC.

4.5. An example of the sector specific risk management available through FRIC is the offer of a reduced motor premium subject to vehicle fleet being fitted with video recording devices. FRIC have quoted a £300 per year saving for each fire appliance, which equates to a saving of circa £10k every year.

4.6. The pooling arrangements require the Authority to provide for the possibility of an in-year supplementary payment of 5.5% of the annual payment. Based on the indicative pricing from FRIC, an in-year payment of between £14,850 and £16,500 could be required which equates to a maximum of £49,500 over the initial period of membership. On this basis it is recommended that the Authority leaves the risk assessed proportion of the General Fund relating to insurance at its existing balance of £50,000.

4.7. Officers have provided a much more detailed return to FRIC in preparation for the on-boarding process and await firmer prices from FRIC.

5. Legal Implications *(The text in paragraphs 5.1 to 5.7 has been provided by the FRIC)*

5.1. The Pooling arrangement recommended here takes the legal form of a Hybrid Discretionary Mutual. In arriving at this model, various options were considered. These options included a buying group, a fully authorised insurance mutual, a fully discretionary mutual and a hybrid discretionary mutual. They are all forms of pooling. However, to take risk a pool needs a formal structure and one that does not infringe regulatory requirements.

5.2. The Hybrid Discretionary Mutual route was chosen since this allows pooling of risk, combines the benefits of a discretionary mutual in terms of structural precedent, flexibility and provides authorised, rated insurance for the larger losses. As well as producing financial benefits in terms of annual cost, it is also capital efficient.

5.3. Discretionary mutuals have been in existence for over 150 years. The legal basis for them was well established in the seminal case Medical Defence Union vs Department of Trade (1979) where the court ruled that such structures did not fall foul of the Insurance Acts since the members only had the right to have their claim considered.

5.4. The Financial Conduct Authority has published guidelines as to what constitutes insurance and has followed the principles laid down in the Medical Defence Union case. As a result it is clear from both the case law and the Regulatory regime that such mutual do not constitute regulatory activity.

5.5. The Mutual (through the managers) will however be purchasing insurances (group excess of loss contracts) on behalf of the members and as such will be carrying out Intermediary activities which are regulated. There are two options for the mutual under the FSMA 2000 S19 and FSMA (Regulated Activities) Order 2001. Either the mutual can be regulated under its own name or it may become an appointed representative of another authorised person. The option taken was the Discretionary Mutual model. FRIC was created as a company limited by guarantee and trades as an Appointed Representative of an authorised Principal (its Manager in this case). There is no capital requirement. Start-up costs were funded by founding Members and thereafter the business aims to be self-sustaining, funded by Member Contributions as determined by the Board.

5.6. The Hybrid structure is based on the discretionary mutual retaining a portion of each risk, subject to a predetermined finite figure (an aggregate limit) and then the mutual arranging an insurance policy to sit above the Mutual's retention with all members named as an insured on that policy (a group excess of loss policy). In this way the members can all say that they are 'insured' under the group policy but with a high excess which is covered by their discretionary mutual. This has the added advantages that a letter of credit from the mutual in favour of a fronting insurer only needs to cover the mutual's retention and not the whole risk and there is still a substantial saving in that the contributions remaining in the mutual do not attract Insurance Premium Tax of 12%.

5.7. The structure of the pool consists of a company limited by guarantee with members and not shareholders. Each member has one vote at an AGM and the membership will elect a Board from amongst their number. Returns of surpluses, if any, will be made pro rata to each member's proportion of contributions. The Board is non-executive and it contracts with a professional mutual management company to outsource the day to day operation of the mutual. The Board will make all the policy decisions and the managers' job is to carry out those decisions and bring all the necessary insurance and management skills into the equation to make sure the mutual runs well.

6. Risk Assessment

6.1. The risk of FRIC failing is deemed extremely unlikely. FRIC is now well established and has a mature operating arrangement. There is some history of issues with mutual insurance arrangements however changes in legislation and appropriate operating arrangements have resulted in a number of examples being or planned to be put in place. In this event because FRIC buys Excess of Loss and Aggregate insurance the liability of FRIC for adverse claims costs are capped in any one year. Should FRIC fail the Authority's exposure is limited to £100.

6.2. FRIC produces quarterly management accounts, monitors movement in previous years and members are kept fully appraised through the Board. In trading to date since November 2015, there is nothing to suggest a cash call will be required, indeed the opposite is currently true evidenced by the current surplus. There is an EU compliant Framework Agreement that can be used by the Authority to obtain cover beyond this.

6.3. FRIC, through its current arrangements, provide cover to its existing members. In the initial work there is no indication that these covers are in any way inferior to those currently enjoyed by the Authority.

6.4. As a mutual FRIC cannot guarantee that claims will be paid which could expose the Authority. FRIC representatives explain that trust is a key element in the mutual arrangement and there is no record of a claim being refused. With appropriate capitalisation in place, an exceptional option for an in-year supplementary payment and a high profile, sector specific, risk management arrangement, a set of circumstances where a claim would be refused appears unlikely, unless the Authority had failed to take action recommended by FRIC to improve its claims performance.

6.5. The traditional approach would be to enter into a contract for typically between three to five years and the cost of the insurance would be set for the first year with a long term agreement to limit increases to broad measures of price inflation unless circumstances changed significantly. With FRIC there is no long term agreement and a new "price" is set each year. There is a risk that costs would increase significantly above that allowed for in the budget setting process. The risk of this is very low as no members have left FRIC, none have raised cost increases as an issue and ultimately the indicative costs are offering a large saving.

7. Conclusion

7.1. The Authority has relied on the traditional approach to procuring and providing insurance cover, the financial mitigation to risk and the statutory obligation to protect its employees and the public.

7.2. FRIC is an innovative yet mature alternative to the provision of insurances cover that specifically supports the fire authority sector. Joining FRIC allows the Authority to work collaboratively with other fire and rescue authorities, both in insurance and business risk management.

7.3. Although the quotes are indicative, when compared to current premiums, the savings are significant.

7.4. The on-boarding documents have been completed and submitted to FRIC and a more certain price is expected. FRIC representatives have said that the whole process will be completed comfortably for 1 April 2019.