



RISK FINANCING STRATEGY

DRAFT

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1. Introduction

- 1.0 This strategy document provides an overview of the Council's approach to risk financing together with a summary of present arrangements and future aims. The document will be of particular relevance to the Audit Committee in respect of their responsibility for overseeing the Council's risk management arrangements and to members of the Council's Risk Management and Controls Assurance Group who are charged with co-ordinating and facilitating development of the Council's risk management arrangements.
- 1.1 The Risk Financing Strategy is a component of the Council's overall Risk Management Strategy. This document therefore needs to be considered in conjunction with the Risk Management Strategy document.
- 1.2 The Risk Financing Strategy will be reviewed annually as part of the review of the Risk Management Strategy document. The review will be under the direction of the Chief Internal Auditor and any significant amendments will be presented to the Audit Committee, as the member body responsible for overseeing the Council's risk management arrangements, for approval.
- 1.3 The risk management function is provided via the Internal Audit, Risk and Assurance Service within the Directorate of Resources. The service is lead by the Chief Internal Auditor with the support of the Risk and Assurance Manager.

2. Definitions

- 2.0 **Risk** - "the combination of the probability of an event and its consequences".
- 2.1 **Risk Management** - "the culture, processes and structures that are directed towards effective management of potential opportunities and threats to the organisation achieving its objectives".
- 2.2 **Risk Financing** - "Utilisation of source(s) of funds to pay for losses. Source(s) of funds can be classified as:
- a. *internal* - a risk retention arrangement is established to use funds from within the organisation to pay for losses.
 - b. *external* - a risk transfer arrangement (generally through the purchase of insurance) is established to provide access to funds to pay for losses.
- 2.3 Risk financing is an important element of the overall risk management strategy on the basis that it is neither possible nor indeed desirable to eliminate all risks from service delivery, projects or initiatives. The purpose of risk financing is, for those risks that are insurable, to seek the optimum balance between the amount of insurance cover that is purchased externally and the degree to which the council self insures. The aim is to have in place a programme that provides appropriate and adequate protection for the Council to support and enable current and future service delivery in addition to being able to demonstrate value for money.

- 2.4 Although much of this document refers to either self insurance or external insurance cover, other risk financing techniques may be used and these will be referred to as appropriate. In addition, there are an increasing number of 'alternative risk transfer' ("ART") options being developed by insurance brokers and other external organisations in response to issues concerning competition and market capacity. These will also be referred to where appropriate.

3. Structure, Resources and Accountability

- 3.1 In accordance with the Council's Financial Procedure Rules the Chief Financial Officer (Executive Director of Resources) has responsibility 'to advise the Cabinet on proper insurance cover where appropriate, and effect corporate insurance cover, through external insurance and internal funding'.
- 3.2 The Risk and Assurance Manager reports to the Chief Financial Officer on all strategic risk financing issues. The Risk and Assurance Manager is the corporate adviser on risk financing and is responsible for ensuring that the adopted strategy is implemented and is subjected to annual review.
- 3.3 Risk Management and Insurance, within the Internal Audit, Risk and Assurance Service, is responsible for supporting the identification and management of significant business risks and confirming that, where appropriate, effective risk transfer mechanisms are put in place.
- 3.4 With regard to risk financing there is specific responsibility for:
- Maintaining adequate and cost effective risk financing measures which include self insurance arrangements in addition to placing cover with external insurers;
 - Managing the Council's self insurance provision including the setting of contribution levels;
 - Providing insurance advice, guidance and support to the Council's business units;
 - Arranging, as appropriate, the placement of cover with external insurers including the negotiation of premium rates and policy terms; and
 - Managing and providing a claims handling service to process claims made by departments or business units and by members of the public;
- 3.5 The recharging of insurance section costs is added to external premium costs as a percentage oncost. The total premium costs are then allocated to individual cost centres on an equitable basis.
- 3.6 The Risk and Assurance Manager will act as Contract Manager for the appointment of an insurance broker/advisor to provide broking services and consultancy services on both risk financing and risk management. The appointment will be made in accordance with the Council's Contract Procedure Rules and will be undertaken in consultation with the Council's Corporate Procurement function. The contract will be re-tendered at least every five years, with contracts offered on the basis of a three year term with the option of extending for up to a further two years subject to satisfactory performance (unless a longer or shorter term contract or agreement is proven to be beneficial to the Council).

- 3.7 The timing of any appointment, renewal or extension of an insurance broker/advisors agreement will take place at least six months prior to or post renewal (or tender) of external insurances. This is intended to ensure continuity of service to the Council throughout the annual renewal period.
- 3.8 The Insurance Broker/Advisor will be required to support and assist the Council in respect of both the annual renewal and periodic tender of its insurance portfolio in addition to providing ongoing and ad-hoc advice and assistance on general insurance/risk management and risk financing issues as they arise.
- 3.9 External insurance will be procured in accordance with the public procurement legislation relating to the purchase of financial services and the Council's Contract Procedure Rules. The Council will award contracts for the provision of insurance services on the basis of the most economically advantageous terms and specific criteria will be drawn up for each tender exercise in consultation with the Council's Corporate Procurement function.
- 3.10 The Insurance Broker/Advisor will be required to advise and assist the Council with all aspects of the procurement exercise including the design of a high quality insurance market tender presentation, the preparation and publication of OJEU notices, obtaining quotations and undertaking analysis of tenders, including an assessment of the financial standing of insurers. In view of the importance of external insurance in providing budgetary certainty and the long tail nature of liability insurance claims, the Council will seek a minimum insurer security rating of A- for all insurers.
- 3.11 The insurance tender exercise will take place every three to five years (unless a longer or shorter term contract or agreement is proven to be beneficial to the Council) according to the length of the expiring long term ("LTA") agreement. Although cover is only provided for a 12 month period it is common practice for there to be an agreement between the insured and insurers that cover will be renewed for the duration of the agreed LTA period subject to various conditions being met on both sides. This obviates the considerable time and expense for the Council in having to formally approach the insurance market (via a tender exercise) each year and provides continuity of cover. In return for this commitment, insurers apply an 'LTA discount' to the premium.

4. Risk Financing Strategy – present and future aims

- 4.1 The overall objective of the Risk Financing Strategy is to ensure that funds are available to pay for losses using the most cost effective sources of finance. In doing so the Council seeks to protect its financial position through the selective purchase of insurance cover and seeks to ensure that the risk financing structure is as financially efficient as possible, whilst accepting that financial certainty has a cost.
- 4.2 The aim is to achieve the optimum balance between self insurance and external insurance with the latter intended primarily to protect the Council against the effects of a catastrophic loss and to limit the Council's financial exposure in any one period. The strategy is also aimed at smoothing the cost of risk and minimising year on year fluctuations in costs. The long term aim is to self insure to the highest possible levels where the cost benefit case can be proved, whilst also securing an acceptable level of financial certainty.
- 4.3 The structure of the risk financing programme is guided by the Council's appointed insurance broker/advisor who, in advance of each tender exercise, will be required to

undertake a fundamental review of the current insurance programme and develop an appropriate future programme in consultation with the Council, and to identify and bring to the Council's attention any gaps, or potential gaps, in cover, and to evaluate self insurance against risk transfer options.

- 4.5 The risk financing programme is also reviewed annually as part of the insurance renewal process with a view to ensuring that the Council buys insurance protection at the right level and does not buy unnecessary cover where it is more efficient to self insure. In general, the higher the level of excess or deductible on the insurance policy, the lower the associated insurance premium; however, the benefit of any reduction in premium needs to be carefully considered in relation to the additional exposure placed on the Council and the associated potential impact on the self insurance fund.
- 4.6 The annual insurance recharge to directorates and service areas comprises a contribution to the external insurance premium together with a contribution to the self insurance fund. The insurance recharge process is intended to provide an equitable allocation of the cost of risk financing across all service areas and is based on exposure (i.e. number of employees, vehicles, property sums insured etc), loss/claims experience and other external factors that may impact on future claims experience (i.e. case law, changes in legislation etc).
- 4.7 Managers are expected to control this exposure and therefore the costs by ensuring that appropriate risk management arrangements are in place to prevent, reduce or minimise the risk of loss, damage or injury.
- 4.8 The cost of self insured risk is met from the central insurance provision (self insurance fund) which is managed by the Risk and Assurance Manager. The self insurance fund is monitored on a monthly basis by the Risk and Assurance Manager in consultation with the Risk and Insurance Team Leader to review the adequacy of self insurance provision.
- 4.9 The review considers the monthly and cumulative cost of claims paid in the financial year, together with the fund balance and estimated cost of outstanding claims, to ensure that adequate funds are available to meet current or anticipated future claims costs. If it becomes evident that a shortfall of funds is likely to occur then the matter will be referred immediately to the Executive Director of Resources.
- 4.10 Claims data is supplied by insurers on a monthly basis. The figures are reconciled with data held on the Council's main accounting system. The Council will use this data to monitor not only the cost of losses but also to identify trends in claim types, causes, frequency and values. This data will be used to evaluate the effectiveness of risk management initiatives and processes so that techniques can be changed or adjusted over time. Insurers are required to provide evidence to the Council that their claims handling process, including a sample of individual claims, is subject to independent continuous quality review or independent audit.
- 4.11 In line with good practice the internal 'self insurance fund' is subject to independent actuarial review at least every three years. The purpose of the 'Fund Audit' is to obtain independent opinion on the adequacy of the provisions for funding current and future insurance claims payments across the different classes of insurance. It identifies any projected overall surplus or deficit based on forecasts for expected losses and takes into account those claims that have been 'incurred but not yet reported'. The review also comments on, and takes account of, any external factors that might have an impact on claims costs in the future (i.e. changes in legislation, case law etc).

- 4.12 The 'Fund Audit' report, which is signed off by an actuary, is produced for the Risk and Assurance Manager who has responsibility for management of the 'self insurance' fund. A summary of the report is also provided to the Chief Financial Officer who, in accordance with the Council's Financial Procedure Rules, has responsibility 'to advise the Cabinet on proper insurance cover where appropriate, and effect corporate insurance cover, through external insurance and internal funding'. The report is used to inform future insurance recharge.
- 4.13 The arrangements for claims handling are reviewed as part of the insurance tender exercise with a view to securing the best quality service at a cost that can be demonstrated as providing 'value for money'. In practice the arrangements will normally ~~are likely to~~ comprise a combination of internal and external claims handling arrangements.
- 4.14 Where claims are handled by an external provider the Council will require all proposed claim settlements in excess of £10,000 to be referred to the Council's Risk and Insurance Team Leader prior to settlement. In addition, any unusual claims or those where it is considered that precedent might be set are also required to be referred to the Council prior to settlement.
- 4.15 The arrangements for handling litigated claims will normally be expected to be provided as part of the external claims handling arrangements. This is subject to satisfactory evidence of a robust selection process for legal services providers, value for money and ongoing quality management arrangements being in place.

5. Risk Transfer

- 5.1 The Council will seek to protect itself from contingent liability claims and to ensure that risk is transferred to third parties wherever it is appropriate to do so. Key elements are:-
- 5.2 PFI and Partnerships – All significant partnerships and/or PFI/PPP projects should be subject to a risk assessment process during the planning stage. The risk assessment should be revisited as the project/contract planning progresses to ensure that the risk assessment remains current. The risk financing arrangements of partners and/or bidders for major contracts should be checked by the Project Manager, where necessary, in consultation with the Risk and Assurance Manager to ensure that the Council's financial position is protected.
- 5.3 Hiring of Council premises (including schools) – All formal hire agreements should contain a clause requiring the hirer to indemnify the Council against all claims losses costs and demands, including damage to the Council's property. Hirers will be expected to provide evidence of public liability insurance with a minimum limit of indemnity of £5m,000,000 or such other limit as is deemed appropriate.
- 5.4 Employees' use of motor vehicles on Council business – Prior to authorising a person to drive on duty a manager is expected check the employees' driving licence and seek confirmation that their motor insurance extends to cover business use. The driver is also required to disclose licence changes, insurance changes and relevant medical conditions. The Council will maintain Motor Contingent Liability cover to ensure there is an indemnity available to the Council in respect of liability incurred by the Council arising

out of the use by an employee of their own vehicle, in the event that the employee's insurance cover is insufficient.

- 5.5 Use of contractors and vetting of contractors' insurances - All contractors will be required to produce evidence of public liability insurance cover (and employers liability where appropriate) before the commencement of any works. The responsibility for ensuring that appropriate cover is in place lies with the employing service directorate.

6. Alternative Risk Financing

- 6.1 The Council is committed to securing value for money and securing the most cost efficient source of risk financing. The insurance market for local authorities has traditionally been limited in terms of the number of insurers who are prepared to offer cover, with the net effect that, relatively speaking, it is more expensive than for other industries where competition is more intense.
- 6.2 The Council, in consultation with its Insurance Broker/Advisor, will actively investigate and keep abreast of all options for alternative risk financing structures such as consortia purchasing or joint procurement, risk pooling, captive insurers or the formation of a mutual insurance company by a public sector risk retention group. The foregoing options would however only be considered where any such proposals provided an acceptable level of financial certainty and security and where a cost benefit case is proved to actuarial standards.

7. Communication and Consultation

- 7.1 The Risk and Assurance Manager will ensure that a summary of risk financing arrangements and guidance notes on the reporting of claims and incidents are available on the Council's intranet and are updated on an annual basis.
- 7.2 The Risk and Assurance Manager will also produce an 'Insurance Renewal' briefing paper for the Chief Financial Officer summarising the outcome of the annual insurance renewal process and highlighting any areas where significant changes to cover were made or where certain types of cover were not taken.
- 7.3 The subject of risk financing will also be referred to within the 'Risk Management Briefing' sessions held for elected Members.

8. Testing

- 8.1 Risk Management is an area of activity covered in the Strategic Internal Audit Plan and is also specifically referred to within the Audit Commission's Comprehensive Performance Assessment ("CPA") process.
- 8.2 The Council will seek to compare its performance with other Unitary Authorities and will draw on data compiled by the Chartered Institute of Public Finance and Accountancy ("CIPFA") Benchmarking Study to see where any potential changes or improvements could be made.
- 8.3 A range of performance indicators are also in place.

9. Review

- 9.1 This document will be reviewed at least annually by the Council's Risk and Assurance Manager. Any significant changes will be reported to the Audit Committee as the Member body responsible for providing independent assurance to the Standards and Governance Committee on the adequacy and effectiveness of the risk management framework.

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