

APPENDIX 1

SUBJECT: Actuarial Investigation of Claims Reserves – Summary of findings
DATE: 23rd October 2007
RECIPIENT: Executive Director of Resources / Audit Committee

1. SCOPE:

1.0 This paper summarises the outcome of the actuarial investigation of claims reserves undertaken by AGRC, a specialist actuarial consultancy, who are part of Aon (the Council's insurance advisors). The purpose of the exercise was to review the Council's monetary reserve for outstanding insurance claims occurring in the period 31 March 1992 until 31st March 2007. The report is then used by the Council to assess the adequacy of its insurance claims funding arrangements. Such reviews are undertaken every 3 years in line with good practice.

2. BACKGROUND:

2.0 In common with most large organisations, the Council self insures a proportion of risk with all liability and property claims settled below £100k and £20k respectively being met from an internal insurance fund (the "Fund"). The Fund comprises contributions from all Directorates which are reviewed annually and are based on factors such as exposure (i.e. employee numbers, nature of operations, asset values), claims experience, outstanding liabilities and other external factors that may impact on future claims experience (i.e. case law, changes in legislation).

2.1 For each and every claim received the Council's insurers allocate a 'reserve' which an estimate of the potential cost of the claim. Each individual claim reserve figure is reviewed periodically as and when further information becomes available regarding the merits of the claimants case, extent of injury, value of loss etc. Liability claims represent the vast majority of the total outstanding claims reserve figure and such claims will only be paid where it is deemed that the Council has been negligent and is legally liable to pay compensation.

2.2 The fund position is therefore fluid as claims are repudiated or settled, individual claim reserves amended and new claims are received on an ongoing basis.

2.3 The actuarial review provides a 'snapshot' as to whether the Fund balance as at 31st March 2007 would be adequate to cover all known claims and any future claims (i.e. those that have been 'incurred but not reported') with an incident date occurring on or before 31st March 2007. The review seeks to estimate the ultimate cost of all claims over the period, less the claims paid to date and to identify the required reserve for claims outstanding – this figure is then compared to the fund balance.

3. KEY FINDINGS:

3.0 The Fund balance as at 31st March 2007 was £4.380m. Based on the data, methods, assumptions, limitations and caveats set out in the full report the ultimate estimated value of reserves (as per paragraph 2.3) is £3.476m. The expected value of claims compared with the fund balance figure therefore provides a potential estimated surplus of £0.904m.

3.1 This compares with the position at the last fund audit in 2004 where there was an estimated deficit of £1.599m (this covered period 31st March 1992 to 31st March 2004).

- 3.2 The potential surplus is a best estimate and the report includes a 'best' and 'worse' case scenario which could result in a potential surplus of £2.101m or a deficit of £0.168m. The ranges are only indicative but can be broadly interpreted as meaning that there is a 25% chance that actual cost of claim payments will result in a surplus greater than £2.101m (the lower range) and also a 25% chance that the actual cost of claim payments will produce a deficit greater than £0.168m (the upper range).
- 3.3 It is important to note that analysis of asbestos related exposure or claims is outside the scope of this exercise due to the complex nature of the analysis required. The figures also exclude any allowance or analysis of claims with an incident date of prior to 1st April 1992. Prior to this date claims were met in full by insurers i.e. there was no excess on claims and therefore no requirement for an internal insurance fund. The local authority insurance market changed considerably in 1992 following the demise of Municipal Mutual Insurance who had previously insured the vast majority of local authorities.
- 3.4 Although complex statistical scientific modelling processes have been used, insurance is inherently uncertain therefore no estimation model will be perfect. The report has however been carried out in accordance with guidelines issued by the Institute of Actuaries and has been signed off by a qualified actuary.

4. COMMENT:

- 4.0 The purpose of the Internal Insurance Fund is to ensure that adequate funds are available to meet both current and future insurance liabilities. The funding strategy seeks to smooth the cost of risk to the Council and individual service areas and, wherever possible to minimise year on year fluctuations in costs.
- 4.1 It is not possible to consistently maintain the optimum level of funding at all times due to the fluid nature of the Fund and the inherent element of uncertainty associated with insurance.
- 4.2 The report confirms that the position of the Fund has moved from a potential deficit position of £1.599m in 2004 to a potential surplus of £0.904m in 2007 although this figure is subject to the caveats outlined in paragraphs 3.2 and 3.3 together with the other range of 'limitations and caveats' contained within the full report
- 4.3 The actuarial review was based on a 'snapshot' of the position as at 31st March 2007 therefore any potential surplus or deficit is hypothetical as the fund operates on an ongoing basis rather than by operating by individual policy year. This is in line with good practice.

5. ACTION:

- 5.0 The Council's budget setting process requires that figures for the following period are supplied approximately six months prior to the new financial year. Contributions to the Fund for 2008-09 will therefore be reduced from £2.387m to £2.313m. The expectation is that, subject to claims experience, exposure, outstanding liabilities and any other external factors, contributions to the fund will continue on a downward trend.
- 5.1 The Fund will continue to be monitored on a monthly basis by the Risk and Assurance Manager to review the adequacy of self insurance provision. If, at any point, it becomes evident that a shortfall of funds is may occur then the matter will be referred immediately to the Executive Director of Resources.

Further information or a copy of the Executive Summary from the actuarial report is available from:

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