Chairperson and Subcommittee Members
AUDIT AND RISK SUBCOMMITTEE

11 FEBRUARY 2016

Meeting Status: **Public**

Purpose of Report: For Decision

REVIEW OF COUNCIL INSURANCE

PURPOSE OF REPORT

1 This report updates the Subcommittee on the Council's current insurance arrangements and seeks the Subcommittee's approval to investigate a self-insurance fund.

DELEGATION

2 The Audit and Risk Subcommittee has delegated authority to consider this report under the following delegation in the Governance Structure, Section C.3.
Risk Management

7.9 Ensure that Council has in place a current and comprehensive risk management framework and associated procedures for effective identification and management of Council's significant risks.

7.10 Review and evaluate Council's risk management framework and make recommendations to the Corporate Business Committee on risk mitigation.

BACKGROUND

3 It is important for Council to have a comprehensive risk management strategy for all its assets, but especially those deemed to be critical and needing to be immediately reinstated in the event of a disaster. A lot of the risks are managed through the Council's Infrastructure Strategy, and the activity management plans and asset management plans that are linked to it.

4 Insurance is often seen as the first resort for funding the risk mitigation of infrastructure assets whereas there are a number of other approaches that can be considered such as creating specific cash reserves, the sale of assets or building spare debt funding capacity.

5 And insurance itself has many aspects to it. For example, there are trade-offs that can be made between premiums, deductibles and exclusions as well as the levels of insurance cover.

6 In addition, there are a number of changes currently taking place in the local authority insurance environment, notably the investigation of a local authority risk agency and a review of the 60 / 40 funding arrangement between central and local government to restore certain infrastructure after emergencies.

ISSUES AND OPTIONS

Insurance market commentary

7 The Global Risks Report 2016, prepared by the World Economic Forum presents a picture of the evolving global risk landscape on both short-term and long-term horizons. For 2016, involuntary migration and the failure to adapt to and mitigate climate change - including extreme weather events and water and food shortages - emerged as two of the greatest concerns.

8 A recent report from Munich Re noted that 2015 had the lowest losses from natural catastrophes of any year since 2009, with overall losses totalling US$90 billion (previous year US$110 billion), of which roughly US$27 billion (US$31 billion) was insured. However climate scientists' concerns over future potential weather extremes throughout the world mean that premium reductions are not currently anticipated.

9 Kāpiti District and many places in New Zealand have significant first-hand experience of extreme weather events. In addition, a recent report by the Parliamentary Commissioner for the Environment on sea-level rise identified $20 billion of assets within 150cm of the mean high tide.

Local Government New Zealand Insurance Market Review

10 Much of the activity and momentum for change in the local authority insurance space is being driven by the findings of Craig Stobo, from his review of the New Zealand local government insurance market. The three key recommendations are discussed below.

Better risk management by councils

11 In order to be able to get the best insurance for their assets and operations, local authorities need to have a detailed understanding of their risk appetite, risk management and risk mitigation alternatives. Consequently, seeking to insure assets should be one of the last things that is done to manage risk, not one of the first.

Local Government Risk Management Agency

12 A local authority-owned agency should be created to replace the current local authority owned insurers (the Local Authority Protection Programme Disaster Fund (LAPP) and Riskpool – owned via Civic Assurance). The new agency would not be an insurance provider, rather it would provide expert risk management capability.

13 In June 2015, Local Government New Zealand (LGNZ) and central government announced their plans to jointly fund a $1.6 million working group to investigate whether an independent agency should be set up to assist councils with risk management.

14 Craig Stobo was appointed as the Chair of the establishment board, which will work closely with LGNZ, local authorities, and officials from the Department of Internal Affairs, the Ministry of Civil Defence & Emergency Management (MCDEM) and the Treasury. The board's primary task is to identify risk management services that would assist councils and locally owned infrastructure and it is aiming to report back to LGNZ and ministers in June 2016 on whether a new entity should be developed.

Review of the 60 / 40 natural disaster co-funding arrangement

15 Until 1991, central government took full responsibility for all costs associated with the restoration of water and sewerage services after natural disasters. The 1991 Disaster Recovery Plan stated that central government would pay a maximum of 60% of restoration costs in the event of a catastrophe and only if the local authority could show that the damaged assets had been properly maintained and the local authority could meet the remaining 40% through other means (such as reserves, insurance, or mutual assistance schemes). As a means to cover their 40% share, Civic Assurance formed the LAPP mutual assistance scheme on 1 July 1993 in the form of a charitable trust.

16 At the same time that LGNZ and central government announced the jointly funded risk management working group, Local Government Minister Paula Bennett and Civil Defence Minister Nikki Kaye also announced a concurrent review of the existing (60 / 40) funding arrangement between central and local government to restore certain infrastructure after emergencies.

17 The Treasury is taking the lead on this piece of work, and is working with the Department of Internal Affairs, MCDEM and councils on this with a discussion document scheduled for release in April 2016.

18 The consensus appears to be that there is no basis for the 60 / 40 split, hence its review. While nothing has been decided yet, it is unlikely that councils' insurance costs will decrease as a result of the review.

Council's current and prior year insurance – levels of cover and premiums

19 The Council shares its risk profile across councils. From 1 July 2014, the Council elected to withdraw from the LAPP in favour of a shared insurance, for mutual disaster relating to underground assets, policy with Porirua, Hutt City and Upper Hutt Councils.

20 Council now has shared policies for the risk of material damage to property, plant and equipment and infrastructural assets, both above and below ground. The policy includes cover in the event of a natural catastrophe.

21 The broker for all these insurances is Aon. Council still gets its Public Liability and Professional Indemnity insurance through Riskpool.

22 This shared services approach to insurance brings benefits to the partner councils who can obtain similar insurance solutions based on their similar geographical locations. This increased scale of insurance cover enables better spreading of risk for the member councils, allowing them to leverage better premiums from insurers. The increased scale also allows the partner councils to get reinsurance directly from London which has contributed to lower premiums over time. There are also benefits from the councils working together, sharing knowledge and resource to improve the standard of risk management practices across the board.

23 The levels of cover for the 2015/16 year and the insurance premiums for the last three years are given in the tables below:

Table 1: 2015/16 levels of insurance cover

Asset	Type of insurance	Sum Insured (Declared Values)	Limit of Insurance
Property, plant and equipment and above ground infrastructural assets	Material damage and business interruption	$184.75 million	$150 million for any one loss or series of losses arising out of any one event and applying to material damage and business interruption combined.
Underground infrastructural assets	Material damage and business interruption in the event of natural catastrophe	$303.29 million	$500 million combined material damage and business interruption limit for an event involving more than one council for any loss or series of losses arising out of any one event and is subject to one automatic reinstatement at nil charge. Limited to an $80 million sub-limit[1].
Residential property	Material damage	$17.63 million	**Natural catastrophe:** First $0.1 million for each loss event per property to be recovered from the EQC. Any remaining top-up required per loss event per property to a maximum of $17.63 million for 131 properties. **All other losses**: Replacement value per loss event per property to a maximum of $17.63 million for 131 properties.
Motor vehicle		$1.80 million	**Fleet vehicles:** Market or lease value of insured vehicle at the time and place of loss, limited to $0.25 million for any one insured vehicle, unless notified to insurer. **Third party liability:** limit indemnity of $10 million for any one claim or series of claims arising from any one accident

Table 2: insurance premiums for the last 3 years

	2013/14	2014/15	2015/16
Total insurance premiums	$1,252,000	$960,000	$898,720

24 The Council is currently undertaking an insurance procurement process with its partner councils to determine the best insurance broker, capable of delivering comprehensive and competitively priced insurance cover for the 2016/17 year.

---

[1] The $80 million sub-limit is the maximum amount that the Kāpiti Coast District Council could claim in an event involving more than one council for any one loss or series of losses arising out of any one event.

25 In the 2010/11 year, Council's total insurance premiums were $470,000. Following the Canterbury earthquakes and also other global catastrophes insurance understandably increased significantly, in some cases by hundreds of per cent.

26 The insurance market has now moved on from the Canterbury earthquakes and premiums have decreased, though nowhere near pre-earthquakes level. The shared services approach to insurance has also contributed to Council's premiums decreasing over the last two years.

27 However these premium decreases cannot go on indefinitely so the Council needs to consider other options for reducing its insurance costs without compromising the levels of cover. One such option is self-insurance (or risk retention) which is considered in more detail below.

28 In addition, in the event of a natural disaster resulting in significant, multi-million dollar damage to under the ground infrastructure, Council would need to fund the $1 million deductible for this insurance cover. The $1 million deductible is the first layer of cover for council assets. The next layer is where Council has insurance cover up to its Maximum Probable Loss (MPL) which for 2015/16 was estimated to be $80 million. Central government is currently expected to cover 60% of the $80 million while Council obtains cover for the remaining 40%.

29 A lot of work is being done to increase the understanding of the risks to Council and the best way to manage them. For example, updated loss-modelling work by Aon and Tonkin Taylor in December 2015 showed that Council's MPL could be $130 million, and not $80 million as indicated when 2015/16 insurance was procured. This information, attached as Appendix 1 has been fed into the 2016/17 insurance procurement process.

Self-insurance

30 Self-insurance is where the Council opts to retain some of its potential financial risks, rather than to transfer those risks to a third party such as a retail insurance provider like Aon.

31 As a self-insurer the Council would be liable for all losses up to a pre-determined level. These potential losses could be limited by getting insurance coverage for all losses (either from individual events or cumulatively) above the pre-determined level. Council would fund any claims from either its working capital or from a specifically established self-insurance reserve.

32 At present, Council has a contingency fund, which is a discretionary fund for the purpose of funding unexpected expenditure across the district, for example, leaky home claims, flood events and insurance excess. The funds in this reserve have decreased from $1.13 million in 2011/12 to $0.42 million at 30 June 2015. It is anticipated that the proposed self-insurance fund would be distinct from this contingency fund.

Funding a self-insurance reserve by adjusting insurance levels

33 While the Material Damage and Business Interruption premiums have reduced significantly over the last two years, the level of premium ($548k in 2015/16) means it is still the most obvious candidate for premium savings.

34 Council has a very good claims history with no Material Damage / Business Interruption claims in the last five years. Therefore, it could elect to increase the deductibles for this insurance from $50,000 (non-natural disasters) and a minimum of $100,000 (natural disasters) to, for example, $1 million. This would likely reduce the premium for this insurance by a significant amount.

35 As a result, in the event of a claim over $1 million, Council would be liable for the minimum deductible of $1 million. For all claims under $1 million, Council would be liable for all the costs as it has effectively become the insurer for all events under $1 million. The intention is that the premium savings are used to build up the self-insurance reserve so that, over time, it becomes sufficient to cover the $1 million deductible. The risk is that Council is now liable for all claims of less than $1 million, and it would require funds from the self-insurance reserve and potentially other sources to fund these claims.

36 And, as previously mentioned, the deductible for Council's Natural Catastrophe insurance to cover its Infrastructure is currently $1 million. Building up a self-insurance reserve would also provide mitigation of this risk.

37 The assumptions in the above example need to be tested with the market before any decisions can be made. Accordingly officers are proposing to work with Aon to investigate the above and other scenarios.

38 In order to be able to create a reasonable level of self-insurance reserve over time, an annual transfer to the reserve of $100k would be the minimum suggested amount. Changing the deductibles, the exclusions and / or the level of coverage on the Material Damage and Business Interruption insurance, for example, might reduce the premium by a material amount, for example $100k.

39 A large number of councils, including Auckland, Christchurch and Wellington have already established specific self-insurance reserves which, in combination with externally procured insurance and risk retention and transfer provide a balanced management of risks.

Funding a self-insurance reserve from rates

40 An alternative method of building up the self-insurance reserve, should this approach be agreed upon would be to keep the premiums and all other aspects of the insurance cover at the same level, and simply rates fund the annual transfer to the self-insurance reserve.

41 The 2015/35 Long Term Plan anticipates a rates increase of 4.6% in the 2016/17 year. Using rates revenue to fund the transfer of $100,000 to the self-insurance reserve would result in a further 0.18% increase to what has already been forecast. This is not the preferred course of action.

CONSIDERATIONS

Policy considerations

42 There are no policy considerations.

Legal considerations

43 There are no legal considerations at present.

Financial considerations

44 The financial implications of this report have been set out in the body of the report.

Tāngata whenua considerations

45 There are no tāngata whenua considerations.

SIGNIFICANCE AND ENGAGEMENT

Degree of significance

46 This matter has a low level of significance under the Council Policy.

Engagement planning

47 An engagement plan is not needed to implement this decision.

Publicity

48 There are no publicity considerations at this stage.

RECOMMENDATIONS

49 That the Audit and Risk Subcommittee approves the proposal to investigate a self-insurance reserve fund.

Report prepared by	Approved for submission	Approved for submission
Mark de Haast **Financial Controller**	**Wayne Maxwell** **Group Manager** **Corporate Services**	**Kevin Currie** **Group Manager** **Regulatory Services**

ATTACHMENTS

Appendix 1: Infrastructure – Earthquake & Liquefaction Loss estimate Summary Report