

<b>COMMITTEE:</b>	<b>CABINET</b>
<b>DATE:</b>	<b>10TH APRIL 2002</b>
<b>SUBJECT:</b>	<b>INSURANCE CONTRACT – EXTENSION TO LONG TERM AGREEMENT</b>
<b>REPORT OF:</b>	<b>HEAD OF FINANCIAL MANAGEMENT</b>
<b>Ward(s):</b>	All
<b>Purpose:</b>	To consider extending the current insurance contract for a further two years ending on 31 <sup>st</sup> March 2005.
<b>Contact:</b>	Bruce Bird, Head of Financial Management,  Telephone 0323 415146 or internally on extension 5146.
<b>Recommendations:</b>	<b>Cabinet is recommended to approve an extension to the existing insurance contract for a further two years ending on 31<sup>st</sup> March 2005.</b>
<b>1.0</b>	<b><u>Background</u></b>
1.1	The Council's existing insurance contract is with Zurich Municipal (ZM).  It commenced on 1 <sup>st</sup> April 1998 as a three year long term agreement with an option, at the sole discretion of the Council, to extend for a further two years.
1.2	The Council chose to exercise its option following a report to this Committee on 27 <sup>th</sup> September 2000.  The contract is now due to expire at 31 <sup>st</sup> March 2003.

1.3	<p>ZM has recently issued its renewal terms for the year commencing 1<sup>st</sup> April 2002.</p> <p>This shows a year on year increase in premia rates averaging 35%.</p> <p>This amounts to an extra cost of £70,000 in 2002-2003.</p>
1.4	<p>ZM has put forward an alternative proposal.</p> <p>Subject to the Council agreeing a further two year extension to 31<sup>st</sup> March 2005, the increase would be limited to an average of 22%.</p> <p>This amounts to an extra cost of £47,000 in 2002-2003.</p>
2.0	<p><b><u>Reasons for the increase</u></b></p>
2.1	<p>There is no doubt that the insurance market has been hardening for some time now. For example, we have been bearing increases in premia rates over the past two financial years, but at rates that are largely containable within the annual budget provision.</p>
2.2	<p>Current market rates on offer, and the effect on next years budget and beyond, have escalated still higher as a result of four principal factors -</p> <ul style="list-style-type: none"> <li>· <b>Competition - reduced competition due to mergers and acquisitions has limited capacity and created an upward pressure on premiums. In addition, insurers have been leaving the market including the demise of the Independent insurance company in June 2001</b></li> <li>· Interest rates - in recent years most insurers have been dependent on investment returns for profitability. Insurers are currently experiencing reduced returns due to the low level of interest rates and an under performing equity market.</li> <li>· Claims costs - liability awards have been increasing. The volume of claims is also increasing due to the emergence of a blame culture, fuelled by no win no fee legal advice. The actual cost of claims has risen, which has produced claims costs exceeding the</li> </ul>

2.3	Some of these factors were starting to emerge when Council took its decision 18 months ago to extend the existing contract. Since then the market has continued to harden, exacerbated by the effect of the events of September 11 <sup>th</sup> . The reasons for the contract extension to 31 <sup>st</sup> March 2003 are borne out and reinforced by current market conditions.
3.0	<b><u>Market Analysis</u></b>
3.1	Independent brokers and consultants, Marsh UK, have provided market analysis, a synopsis of which is set out in the paragraphs above. They also advise that the insurance market is seeing average rises of 50%.
3.2	The advice from Marsh is to accept the terms on offer from ZM and extend the existing contract for a further two years. As a minimum this would give the benefit of the lesser cost increase for at least one year, and possibly three. If ZM were to break the deal at the following annual renewal, the Council could still choose to go to tender.
3.3	<p>This is clearly not a situation unique to this Council. Other Council's at similar stages in their own contracts with ZM are having to consider similar options. For example, East Sussex County Council has dissolved the final year of its previous contract with ZM to enter into a new three year contract which takes advantage of the lesser of two cost increase proposals. The County did actually test the market by placing an OJEC notice, but received no enquiries whatsoever.</p> <p>Surrey County Council was in a similar situation to East Sussex but opted to extend with ZM without a tender exercise.</p> <p>Wealden District Council has recently agreed a one year extension with ZM within the existing arrangement.</p> <p>Hastings Borough Council, perhaps pre-empting the hardening market, arranged a 7 year deal with ZM in February 2000.</p>
4.0	<b><u>Risk Management</u></b>

4.1	One of the advantages in extending the contract until March 2005 is that it gives the Council time to develop and implement a corporate risk management strategy. Insurers are increasingly looking for evidence of risk management practices when pricing tenders, which provides a very real financial incentive.
4.2	Members will be aware from the recently completed Best Value Review of Finance that the Head of Audit is set to lead on the development of a corporate risk management strategy. This work will start from October 2002 and embrace the whole authority. The Head of Audit will be supported in this work not only by staff from within the Finance and Corporate Services department but also by staff across all departments. The Best Value Improvement Plan also envisages joint working on risk management with Hastings Borough Council.
<b>5.0</b>	<b><u>Consultations</u></b>
5.1	Consultations on the insurance market have taken place with Marsh UK, independent consultants and brokers.
<b>6.0</b>	<b><u>Financial implications</u></b>
6.1	The Council's insurance costs are set to rise significantly. Extending the existing contract to March 2005 will at least reduce the increase from £70,000 down to £47,000 per annum. This may be further reduced by electing to take higher excesses on some covers - a trend that insurers are in any event looking to impose.
6.2	The Council's budget for 2002-2003 made provision for an increase in insurance costs based on our expectation that premia rates would rise. During the budget process ZM advised that this was likely to be the case, but was not able to be definitive until its underwriters had assessed all of the relevant factors (see paragraph 2 above) and set the renewal rates. These became available in mid February, after Cabinet had made its formal budget recommendation to Council.

6.3	<p>The precise extent of the budget impact for 2002-2003 will be known by the time that in- year budget monitoring gets underway in June. This will be reported to Cabinet through the bi-monthly monitoring reports.</p> <p>The level of extra insurance costs over and above the budget will have to be met either from in-year savings, or from the contingency budget, or from a mix of these two.</p>
6.4	<p>The Council's 5 year revenue budget strategy will need to take account of the impact of this increased cost pressure, together with the financial benefits of developing and implementing a corporate risk management strategy.</p>
7.0	<p><b><u>Implications</u></b></p>
7.1	<p>Financial Regulations require Council approval to significant variations in budgets and expenditure (Financial Regulation 4.5) and to significant variations in contract prices (Financial Regulation 10.8).</p>
7.2	<p>There are no other implications arising from this report.</p>
8.0	<p><b><u>Conclusion</u></b></p>
8.1	<p>Given the hardening market conditions in which insurance cover is being sold, the existing contract with Zurich Municipal continues to represent best value for the Council.</p>
8.2	<p>A two year extension to 31<sup>st</sup> March 2005 not only limits the financial pain, but also gives the Council time to develop risk management and other management strategies.</p> <p>If Zurich Municipal were to break the deal at the next annual renewal, the Council could still choose to go to tender.</p>

<b>Bruce Bird</b>	
<b>Head of Financial Management</b>	
<b>Background Papers:</b>	
The Background Papers used in compiling this report were as follows:  Cabinet report 27 <sup>th</sup> September 2000	
Ref: OpenlinkCFO/Reports/Cabinet 02.04.10/ZMcontractextension	