Establishment of the London Authorities' Mutual Ltd (LAML)

A Case Study

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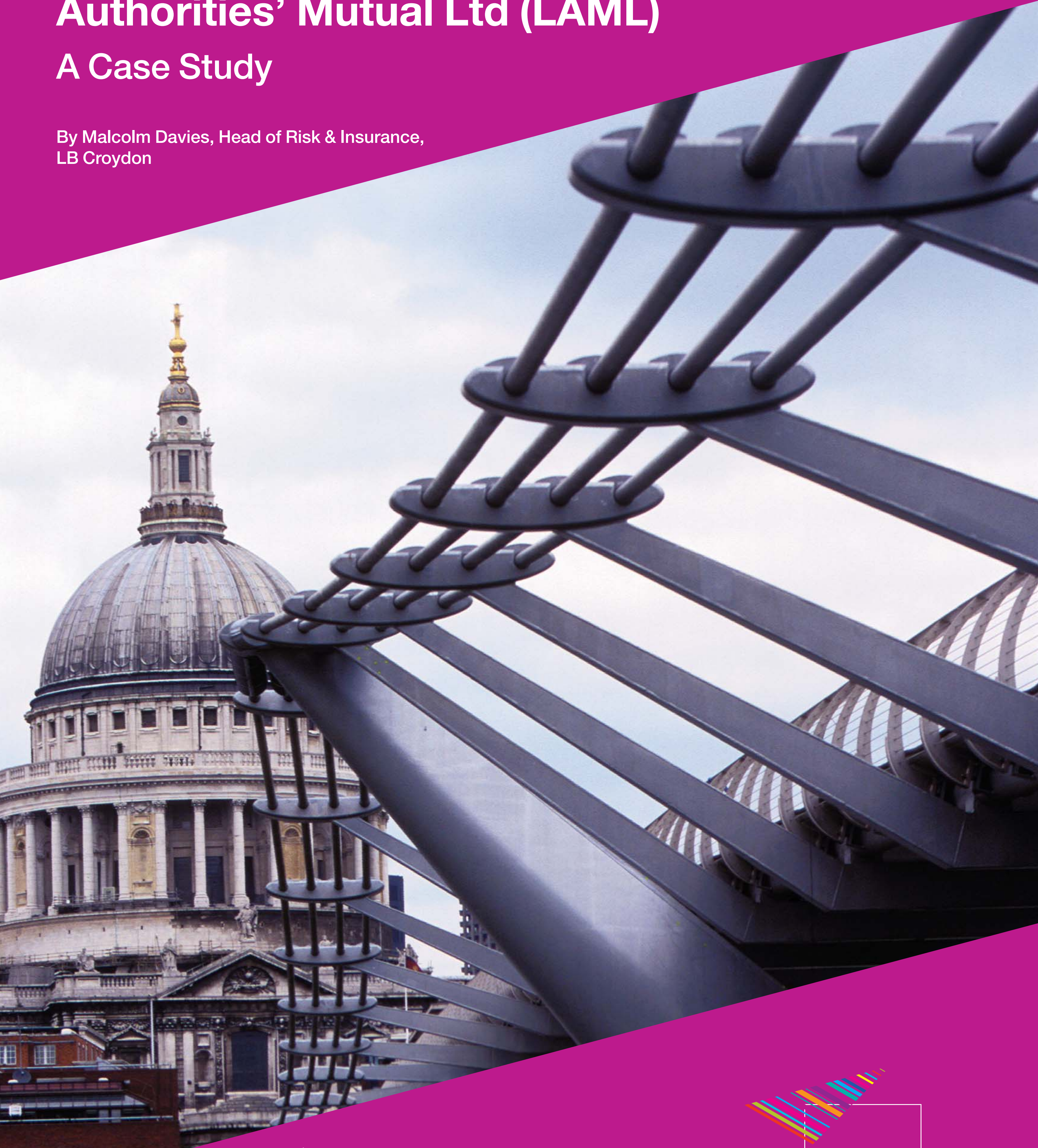

Improvement through efficiency

LAML
LONDON AUTHORITIES' MUTUAL LIMITED

Centre of Excellence
London

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THE ORIGINAL CONCEPT

The history of the local authority risk financing is perhaps best traced back to 1903 with the formation of Municipal Mutual by a group of local authorities anxious about high premiums and lack of competition from the insurance market.

By 1974 it is reported that over 90% of local authorities placed some form of business with Municipal Mutual Insurance. The company continued to work well until the early 1990's when, for a variety of reasons, MMI itself ran into financial difficulties and by 1993 had stopped writing new business.

The response to the difficulties of Municipal Mutual provoked different reactions in other parts of the world. In the early 1990s MMI had engaged in an aggressive expansion programme among Australian local authorities. When MMI ran into problems, groups of local authorities opted to form their own insurance companies or risk pools to insure themselves effectively. High level reinsurance was purchased collectively to protect against poor loss experience.

This concept of 'risk pooling' has also found favour with governmental entities in other parts of the world notably the United States, Canada, South Africa and New Zealand all being good examples of the concept.

Two key features often pertain to these type of schemes:

Homogeneity of risk

The grouping of authorities together that are similar in size and function i.e. county councils together, Metropolitan Borough Councils, districts and unitaries in their own groups.

Regionality

Grouping together authorities which have a similar profile often includes issues around regionality. The North East, for example, has quite a different risk profile from the South West. Also, groups of authorities in one region will often already have frameworks or networks to work together which do not exist on a wider area basis.

The idea of a group of local authorities in the UK developing such a model was first discussed in the mid 1990s. It is fair to say that at this time the concept was perhaps too new and also floundered on doubts over the legal powers of local authorities to work together to create such an operating entity.

Since then discussions have continued around the possibility of establishing such a venture but, until the last couple of years, nothing substantive has emerged until work commenced on the feasibility for establishing such a vehicle for the London boroughs.

WHAT WAS THE CATALYST FOR THIS PROJECT?

Legal Powers
The Local Government Act 2000. The so called 'well being powers' have been designed to effectively allowed local authorities to work together for any purpose likely to promote benefit, financial or other, in their own area.

Best Value
It is perhaps self evident to say that authorities who have, for example, a premium spend of £1M per annum or more might find it difficult to demonstrate best value if they perhaps have only 2 or 3 serious contenders for their major classes of insurance business.

Gershon Efficiency Review (Spending Review 2004)
Local authorities under increasing pressure to meet their Gershon efficiency targets and keep down council tax increases are looking at new and more innovative ways of meeting their targets. Joint working is one possible avenue to explore.

Shared Services Agenda
At the moment it is difficult to find many concrete examples of local authorities working together to achieve efficiencies in the way that services are delivered to them or to the public.

This has been followed up by *Sir David Varney's Service Transformation Review 2006*. The review was conducted for the Treasury and focuses on innovation in the delivery of public services.

'I should reiterate that making provisions to share corporate services is not easy, but it is certainly worthwhile. I would urge any of you who have not yet put plans in place to begin sharing to begin the process as soon as possible. Doing nothing simply cannot be an option.'

David Myers, Director, Shared Services, Cabinet Office

To some extent, all of these drivers for change have informed authorities' thinking in relation to joint working on projects such as this.

THE ISSUES FACING THE INSURANCE AND RISK MARKET FOR LONDON BOROUGHS

In October 2005, 28 out of 34 London boroughs (a remarkably high number) took part in an extensive study to build up a full picture for London of:

- Who the insurers were
- The basis of insurance cover
- The claims experience
- Premiums paid

The study highlighted what is believed to be a national picture on property insurance. This market has been dominated by one player with only token involvement from other insurers. On Employer and Public Liability, the picture was slightly more diverse with involvement of two other large players.

London authorities were usually carrying large excesses under their policies, typically £100,000 plus. For many London authorities, this meant that it had been several years since they had actually made a claim against their insurers.

The total premium spend for London authorities participating in the original feasibility study was at that time £36M for Property, Liability and Motor covers.

The feasibility study demonstrated that the establishment of an insurance company set up by and for the benefit of London authorities could potentially generate not only premium savings for the participants but longer term benefits for those London authorities taking part.

Crucially, the study also highlighted the issue of authorities being locked into long term agreements with their current insurers. The majority of London authorities had long term agreements expiring in 2007 or 2008. This pointed up to a window of opportunity to establish such a company at the earliest opportunity or lose the opportunity to gain members for three or maybe five years.

HOW WOULD IT WORK?

The proposal was to establish a guaranteed indemnity mutual insurance company, owned and guaranteed by its members the London boroughs. As such the company would be authorised and regulated by the Financial Services Authority (FSA) and its business model would undergo a rigorous analysis by the FSA.

As an authorised insurer, the mutual would issue statutory covers such as Employer Liability certificates and access Pool Re, the government backed terrorism insurance scheme. The covers issued by a guaranteed indemnity mutual are contractually enforceable making the security offered by this type of body the same as any other insurer.

Essentially, the model works on the basis of utilising the collective spread of risk represented by the participating authorities. It does this by retaining a higher degree of risk collectively than would be possible individually. Also, collectively the premium spend of the mutual and higher risk retention by the mutual accesses new insurance markets which are not necessarily accessible individually.

The point of such a vehicle is that is directed by its own members and aimed at meeting their needs rather than the wider market. As well as attempting to offer upfront premium savings, such a model means that operating surpluses are retained by the members rather than paid away to third party shareholders.

The investment policy and strategy is again determined by the participants. This is also an important factor for local authorities. Covers themselves are orientated around the needs of the local authorities where members have a much greater input into how these look.

THE ROUTE TO ACHIEVING THE SOLUTION

Prior to October 2005, contact had been made with the London Centre of Excellence (LCE) one of the 9 regional centres of excellence which now report into Communities and Local Government (CLG). The idea had first been discussed at the Society of London Treasurers (SLT).

Funding for the project feasibility study was secured and the project, then lead by LB Croydon with Malcolm Davies, Head of Risk & Insurance, acting as project manager with a peer group of risk & insurance managers.

Charles Taylor Consulting was appointed to run the feasibility study and this reported back in

January 2006 as above. The findings of the report were reported back to the participants and to SLT in January 2006 to gauge how much support there was to proceed with implementation of the report recommendations.

Again, the LCE was instrumental in funding consultants and legal costs associated with setting up such a company. In April 2006, work commenced to set up the company.

In May 2006, a new survey looking at premium levels was launched. This time all London authorities participated. This enabled the financial models to be reconfirmed and firm proposals to be drawn up for membership. At this point, a target number of authorities willing to participate was set by the steering group at 6 and a series of seminars and briefings was held for various groups. These groups included Treasurers, Insurance Managers, Procurement Managers and Heads of Legal as well as individual authorities. This process concluded October 2006.

THE ORGANISATIONS INVOLVED

Nathan Elvery, Director of Finance & Resources at Croydon Council championed the project. Nathan provided weekly reminders to fellow London borough finance directors to obtain commitment from their authorities to recommend this project to their Members. This was to establish that a viable number would participate in the mutual from the expiry of their current Long Term Agreement. The target number of authorities to be involved in setting the company up was comfortably exceeded.

This leadership was essential to taking the project through to the next level and establishing a working group of Finance Directors on the project. Creating this level of certainty was vital to establishing the business case for setting up the mutual and how it would be capitalised etc.

Those boroughs committed to setting the company up were:

- LB Brent
- LB Harrow
- LB Tower Hamlets
- LB Camden
- LB Croydon
- LB Lambeth
- LB Haringey
- LB Hammersmith & Fulham
- LB Islington
- RB Kingston

THE IMPLEMENTATION

Having established the participating authorities, a series of actions were carried out:

A final business model submitted to the Financial Services Authority in October seeking authorisation as a regulated insurer

A new working group of risk and insurance managers was established composed of the participating authorities

Regular communications set up between the Directors of Finance of the 10 participating authorities to facilitate the establishment of the company.

THE BOARD

An early concept of the project was to have a company board of Directors that comprised of senior representatives of the participating authorities. To this end, nominations were sought from Directors of Finance of London boroughs. Six nominations were made:

- Nathan Elvery, LB Croydon
- Mike Suarez, LB Lambeth
- Mike Curtis, LB Islington
- Mike O'Donnell, LB Camden
- Gerald Almeroth, LB Haringey
- Myfanwy Barrett, LB Harrow

In addition, two independent directors were appointed, Lord Remnant and Michael Payton senior partner of Clyde & Co.

All appointments were made by the company were also approved as fit and proper by the FSA. This reflects a key part of the project which is about demonstrating clear governance from the participants themselves rather than third parties.

THE OPTIONS OFFERED

In January of 2007, London Authorities' Mutual Ltd as it was now constituted went out to the market to procure the services which would be needed for the operation of an insurance vehicle. These were:

- Reinsurance for the company itself
- Risk Management and Loss Control Services
- Claims Handling

The procurement exercise was characterised by an unprecedented level of interest from the insurance market, perhaps due to a number of factors including the innovative nature of the proposal. Significantly for the insurance market, new players for reinsurance have been introduced to the local authority market.

THE CHALLENGE AHEAD

What are the challenges that lie ahead?

Many of the practitioners around the world will point to the longer term benefits that this type of scheme brings. This includes:

- Joint commitment to loss control
- Commitment to work together to develop and benchmark against Risk Management standards
- Commitment to innovate

One of the drivers in London is the recognition that events or emergencies do not respect local authority boundaries. Therefore, there is a big incentive for authorities to work together on issues such as business continuity to ensure a mutual resiliency of the participating members.

It is this long term commitment to learn from the best in each authority which represents such a challenge to participants. Such a scheme stands or falls by the degree of participation and dialogue from each member and the degree to which they feel they have ownership of the vehicle.

THE SUCCESS ACHIEVED AND THE LIKELIHOOD OF OTHERS TO FOLLOW

The hurdles to overcome to get to this point have been immense, partly because this type of project had not been pursued to a successful conclusion before.

LAML quite purposely is designed to look and feel different. It is marked by a high degree of collaboration and involvement from the participating authorities at all levels. This brings significant benefits and this degree of ownership is considered to be one of the key successes of the project.

In addition to issues around premium reduction etc, the project has been able to deliver enhanced covers such as automatic higher limits of indemnity on liability covers and environmental impairment cover which has not been available to local authorities on a blanket basis since the early 1990's.

There has, however, been a large element of interest generated within the rest of the public sector by this scheme. The prospect of new schemes starting is therefore much higher now that legal, financial, regulatory and other factors have been addressed by this project.

One example is the fire authorities which are actively pursuing a similar scheme and the prospect of others is looking increasingly likely. Only time will tell but certainly LAML is set for the long haul and to demonstrate that authorities can work together of their own volition and for their mutual benefit.

RELEVANCE TO CSR 2007 AND BEYOND

Looking forward to the delivery of CSR2007, LAML's formation is even more relevant in that it:

- Is a practical example of a shared service working that can readily be utilised by any cluster of authorities across the UK
- Supports the smarter procurement agenda in that it will not only reduce direct costs but allow the public sector to use its considerable influence to shape markets and the choice of products and services available

For further information on the London Authorities' Mutual Ltd, please visit the dedicated website at www.londonauthoritiesmutual.co.uk.

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