LATE ITEM

TABLED DOCUMENT

Tabled at Finance/Performance Committee

On 31 March 2016

REPORT

SUBJECT: **Options for insuring Council's below-ground infrastructure assets – further consideration 2016**

TO: Finance/Performance Committee

FROM: George McIrvine

DATE: 8 March 2016

FILE: **3-FM-6-6**

Attachments **April and May papers 2014 and Treasury 60/40 Cost Sharing Reform.**

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1 Executive Summary

1.1 Council has no options for insuring its below-ground infrastructure assets in 2016/17 other than through Civic Assurance's LAPP Fund.

1.2 From 1 July 2017, Council has potentially two options; one option is to remain in the Local Authority Protection Programme (LAPP), a mutual fund, with an estimated contribution of $53,360 (2016 contribution). The other option is to give notice of its intention to withdraw from LAPP so that Council could be part of the likely to be established Local Government Risk Agency (LGRA).

1.3 Council has previously given notice of its intention to withdraw from LAPP, prompted by the requirement on members in 2012/13 and 2013/14 to accept a degree of mutual self-insurance, i.e. a contingent liability, which for Rangitikei could have been as much as $805,000. The LAPP trustees have decided this requirement was not needed in 2014/15.

1.4 LAPP is a mutual fund, and more than half of the Council's contribution in 2013/14 was used for building up the fund, to reduce the amount of reinsurance needed. This means the amount of the annual contribution is likely to decline, so long as no major event occurs to any member of LAPP.

1.5 When the LGRA is formed, it is very likely that Central Government will change the current risk sharing arrangement of a 60/40 split between Central and Local Government.

1.6 It would make sense for Council to have its options open when this agency is formed by giving notice to leave LAPP prior to the end of the financial year.

2 Background

2.1 The position from 2 years ago is outlined in the papers attached as Appendix 1. Council remained with LAPP and currently has its underground assets insured with LAPP with no notice to leave in place.

2.2 As noted in 2014, LAPP is still involved in legal action with its re-insurers AIG with its latest half-year accounts at 30 June 2015 showing an Insurance provision liability of some $486,334,000 and a re-Insurance receivable asset of $488,188,000.

2.3 In June 2015 an establishment board, of a Local Government Risk Agency (LGRA) was formed under the auspices of LGNZ to investigate a similar agency model to the LGFA. Craig Stobo author of the previous report of the same name chairs this board.

2.4 It is our understanding from a recent AON (MW LASS insurance broker) risk seminar that further work on this by Treasury officials to look at how this agency could work. Work is also underway on funding this with an intention to make local government more involved in the risk management of their assets and more accountable for their risk management.

2.5 This work also includes the current 60/40 central/local government split with a stated intention that this does not continue but some arrangement with greater certainty as to costs particularly for central government included.

2.6 Council may give notice of its intention to withdraw from membership of LAPP by 30 June 2016. This will take effect from 1 July 2017 unless it is withdrawn before 30 June 2017.

3 Comments

3.1 Civic Assurance in its Statement of Corporate Intent says it does intend to re-enter the local government insurance market in 2016. This is partially as a result of the settlement of the Christchurch City Council Claims by its LAPP fund. It has not provided financial forecasts for this business.

3.2 LAPP has evolved and the majority of the urban councils based on the Christchurch experience have withdrawn from LAPP. This leaves LAPP as a predominantly provincial New Zealand provident fund and re-insurer of underground infrastructure that would reduce its exposure to a major metropolitan disaster risk and would offer less risk to its mutual fund being unable to meet claims than with these large metropolitan centres include.

3.3 A part of LAPP premiums is devoted to building up its reserves to fund a disaster. That is despite many councils carrying significant reserves for emergency and capital funding. It is likely therefore, that ratepayers will end up paying twice for their council reserves and building up LAPP's reserves.

Current reserves are $20M with the pre earthquake 2010 position being $40M which was fully expended as a result of the claims.

3.4 Member councils are required to give one year's notice of intention to leave but are not required to follow through by leaving the fund.

3.5 With the likely formation of a risk management agency for Local Government (LGRA), it would make sense for Council to have the option to leave. To do this Council needs to give notice to leave before the end of the financial year.

4 Recommendations

4.1 That the report 'Options for insuring Council's below-ground infrastructure assets – further consideration 2016' be received.

EITHER

4.2 That Council does not give notice of intention to withdraw from the LAPP Fund.

OR

4.3 That Council gives notice of intention to withdraw from the LAPP Fund from 1 July 2017.

George McIrvine
Finance & Business Support Group Manager

Michael Hodder
Community & Regulatory Services Group Manager

Appendix 1

MEMORANDUM

TO:	Council
FROM:	George McIrvine
DATE:	24 April 2014
SUBJECT:	**Infrastructure Insurances, Membership of LAPP And Shares in Civic Assurance**
FILE:	5-FM-6

Background

At the meeting of the Finance/Performance Committee on 10 April 2014, the Committee considered insurances and in particular infrastructure insurances with reference to the Council's existing membership of the Local Authority Protection Programme (LAPP). The Council has given notice to leave this scheme twelve months ago and is considering its position.

At the workshop the main discussion centred on:

the level of contingent liability that the Council is exposed to by its membership of LAPP for events in other parts of the country, and
the level and quality of cover available and the ability of the insurer to pay-out on these contracts should another major disaster occur, with LAPPs capacity after Christchurch being a real issue.
From this discussion this memorandum seeks to outline the preferences from the workshop and a path for the future in what will be a rapidly changing and evolving sector for a period.

Contingency costs

There was a clear preference to move away from a liability that is contingent on a small council for events that occur elsewhere in New Zealand. The current model used by LAPP means there is a contingency based on a council's level of fee to smaller councils that may be used to settle claims for other larger councils; this also manifests itself in the risks that these other councils pose to any mutually based insurers, like LAPP and the insured, like Rangitikei.

Excess capacity for other council risks.

For example the $250 million 'limit' provided by LAPP is for a pan-New Zealand programme to include risks such as Lower Hutt, Porirua, Tauranga and other large urban centres. The limit is therefore much higher than needed for Rangitikei and, since this capacity costs all councils under the LAPP model, the more we can tailor a programme to better suit (on a regional basis via the MWLASS) the more this helps to reduce the costs and ensures that the rate reflects the inherent exposure and loss history of the region or district. (Unfortunately on that basis – the 2004 regional floods are still considered by the underwriters).

Right-sizing our insurance cover for the 40% (remembering the Government 60%)

The largest loss potential for any council is primarily driven by earthquake and LAPP use a loss ratio of approx. 7% for the average council for the largest earthquake scenario. Since the largest accumulation of the Council's assets is around Bulls and Marton (approx. $60 million) this would presumably give a loss in the region of $4.2 million.

The Aon Risk Engineering provides similar results (although calculated by a different method). Because there are concerns about the valuation of infrastructure assets across New Zealand – and to provide for an additional safety margin – we would propose a sublimit for Rangitikei District Council of $12.5 million. In addition to this limit there would be additional coverage for additional increased cost of working and temporary repairs, meaning Council could claim up to $17 million in any one event. (This equates to an equivalent damage ratio of ~ 28%).

Comparison of LAPP and Insurance

Comparison of LAPP directly with insurance is difficult since the first $100 million of any claim under LAPP is basically funded by local and central government through previous and current contributions and mutual self-insurance with the Central Government's 60% share. However, this is likely to change with the introduction of an Agency to place local government insurance with (associated with a subsidy from central government to purchase additional cover layers. Some councils currently put in place 100% of cover to minimise the risk that they do not have cover from central government which was capped in the case of Christchurch.

With regards to the actual loss expectancies and risk engineering AON is just about to release a report for MW LASS based on the maximum foreseeable loss in or around Wanganui. This report gives a loss expectancy of ~$44 million; however, the overall programme loss limit is currently set higher at $80 million (based on the uncertainty of the loss modelling especially with the values provided).

The Risk Engineering is based on a Maximum Credible Earthquake event (MCE) – there is always the possibility that an unknown fault ruptures (as occurred in Christchurch) – but assuming this type of event makes the loss modelling overly conservative. The loss modelling and loss limits are in AON's opinion conservative and pragmatic. Included in the cover is at least one automatic reinstatement of the earthquake loss limit ($80 million for the MW LASS) and unlimited reinstatements of the limit for all other perils.

LAPP Future

It is clear from the Christchurch event that LAPP over time has not priced their risks appropriately as it anticipated a loss put at $40 million for Christchurch Infrastructure when it was over $1 billion and they collected a little over $1 million in contributions for every $4.8 billion of assets, which was way too low.

As presented in the workshop, there have been suggestions made to LAPP on its structure and offering to the market, one around the layer that they occupy potentially for all insurance cover or having two pools one for large councils and one for small councils like ourselves who do not want to be caught by large risks in largely urban centres or liability claims for leaky homes again in largely urban centres which small rural councils in this region have been called to fund. LAPP has seemed unwilling to change its model or what it offers to the local government market. In discussions with staff at other councils, there would be support for a LAPP that provided a different offering in distinct pools or layers of cover. As this is not the case, and recognising the contingent nature of the potential call on Council, it would seem prudent to exit at this point.

Council's membership of LAPP (and investment in Civic)

Currently there are 46 councils with LAPP of the total of 78 in New Zealand. From discussions with other councils, there are some 20 councils like Rangitikei who have given notice; of those it is likely that 14 or 15 will move out of LAPP, predominantly councils in the Wellington and Bay of Plenty regions.

If the recommendation to leave LAPP is followed, there seems little benefit to invest in the shares in Civic Assurance. However, Council needs to be aware that to re-join LAPP in the future will require a larger investment to purchase into the pool. However, the sector is likely to change markedly with the formation of an Agency and LAPP seems unwilling to change, meaning it may not exist for long.

The local government insurance market and the initiative to form a collective insurance Agency.

In the attached letter and report prepared on behalf of LGNZ on the insurance market which councils face, there is a recommendation which is being actioned by LGNZ that it looks to form a local authority controlled agency including LASS type organisations to manage the risks associated with councils' operations and assets but – critically - does not provide the insurance itself: rather it would place it on behalf of councils with the policies written back to each council rather than the LAPP situation. It would use its intellectual property of its understanding of the assets and the risks to place this insurance in a market and with underwriters who have the capacity to fund this risk.

As proposed in Mr Stobo's report, this agency would have a "light balance sheet" and while it would be owned by councils and the Crown (from which it would receive funding in return for fixing the levels of re-insurance. i.e. removing the current 60/40 central government/local government split which is still in place). It is likely that this central government support will disappear and be replaced with a layered cover across councils to insure their maximum losses on an event like Christchurch, which mutual funds like LAPP in their current format cannot seem to cope with in the New Zealand context.

Short term savings with long term strategy

In the short-term there will be savings of $24,540 from using AON to place the infrastructure insurance compared with LAPP charging $70,000 in the 2014 financial year. This should offer better value than continuing with LAPP as the Council only pays for the level of cover it needs without having a contingency for other councils' risks.

The detailed placement work with the MWLASS and our broker AON needs our asset infrastructure records to be complete before this can be determined fully. We can do this initially based on last year's information but do need this to be fully up to date to ensure that all assets and their risks are insured by the underwriters.

Recommendations

That Council endorse a move to leave the LAPP insurance scheme and also not to invest equity with Civic Assurance.

That Council approve the placement of the infrastructure insurances with AON subject to confirmation of the level of cover and costs via MWLASS (acknowledging that the final premium has yet to be determined on the basis of updated infrastructure records).

George McIrvine
Finance & Business Support Group Manager

REPORT

SUBJECT: **Options for insuring Council's below-ground infrastructure assets – further consideration**

TO: Finance/Performance Committee

FROM: Michael Hodder, Community & Regulatory Services Group Manager

DATE: 8 May 2014

FILE: 3-FM-6-6

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5 Executive Summary

5.1 Council has two options for insuring its below-ground infrastructure assets in 2014/15. One option is to remain in the Local Authority Protection Programme (LAPP), a mutual fund, with an estimated contribution of $70,000. The other option is to withdraw from LAPP and take out insurance through Aon, at an estimated premium of $45,460. Both options preserve the Government's contribution of 60% for the cost of making good damage from natural disasters.

5.2 Council has previously given notice of its intention to withdraw from LAPP, prompted by the requirement on members in 2012/13 and 2013/14 to accept a degree of mutual self-insurance, i.e. a contingent liability, which for Rangitikei could have been as much as $805,000. The LAPP trustees have decided this requirement is not needed in 2014/15.

5.3 LAPP is a mutual fund, and more than half of the Council's contribution in 2013/14 was used for building up the fund, to reduce the amount of reinsurance needed. This means the amount of the annual contribution is likely to decline, so long as no major event occurs to any member of LAPP.

5.4 The main considerations in deciding between the options are (i) the different cash amounts required for 2014/15 and (ii) how each will be applied.

6 Background

6.1 Since its inception in 1993, the Council has been a member of the Local Authority Protection Programme ('LAPP'). It was set up in response to the offer from the Government to pay 60% of the costs for repairing or replacing below ground infrastructure owned by councils which were damaged by natural disasters, if councils contributed 40%. It is a mutual fund, administered by trustees.

6.2 Christchurch City Council was a member of LAPP when the earthquakes in September 2010 and February 2011 occurred. While LAPP met its obligations, the balance of the fund was exhausted and the cost of reinsurance soared as its availability shrunk. As a result, in addition to their individual contributions, members entered into a contingent liability in 2012/13 and 2013/14 for mutual self-insurance, in the event of a major disaster. This reduced the amount of reinsurance. For Rangitikei, the 2012/13 Annual Report calculated this contingent liability as $805,000. Council considered it prudent to exercise its right to give notice of its intention to withdraw from LAPP from 1 July 2014, and subsequently examined alternatives, including taking insurance through Aon, which acts as insurance brokers for MW LASS.

6.3 At its meeting on 2 May 2014, Council considered a report from the Finance & Business Support Group Manager on infrastructure insurances, membership of LAPP and shares in Civic Assurance.[1] This reviewed the discussion held at a workshop on 10 April 2014 and recommended that Council endorse a move to leave the Local Authority Protection Programme (LAPP) and approve the placement of infrastructure insurance with Aon. The projected cost of the insurance premium through Aon was $45,460 compared with the projected contribution to LAPP of $70,000 together with a continuing contingent liability.

6.4 Council resolved to postpone a decision, delegating that to the Finance/Performance Committee at its meeting on 15 May 2014. This decision was prompted from advice from LAPP that it would like an opportunity to inform Council of its proposal for 2014/15.

6.5 Council is required to confirm its stance over continuing membership of LAPP no later than 16 May 2014.

7 Comments

7.1 Since Council's meeting on 2 May 2014, further information has been sought from LAPP. The contingent liability on members of LAPP has been removed for 2014/15. This means that there will be no demand on members' funds if a disaster affects another member: the disaster (up to $200 million, meaning $80 million from LAPP) will be covered fully by LAPP and its reinsurers. This change is the result of reduced cost for reinsurance: while in 2012/13 this was costing seven times as much as in 2010/11, this was halved last year, and will fall more in 2014/15.

[1] This is attached as Appendix 1 to this report (but without a copy of the LGNZ sponsored paper by Craig Strobo 'New Zealand Local Government Insurance Market Review').

7.2 As noted in the earlier report to Council, comparing LAPP with other insurance providers is complex. This is because LAPP is a mutual fund. Part of the contributions from members is used to purchase reinsurance and to cover administrative costs. The remainder goes into building up the fund. In 2013/14, around $27,000 of the Council's contribution was used for reinsurance and administrative costs. This may be the more appropriate figure to use when comparing the projected cost of insurance from Aon or any other provider. As the amount of the fund increases, less reinsurance is needed. That in turn lowers the level of contribution sought.

7.3 Clarification has been obtained to confirm that the LAPP disaster fund does not have any on-going liability, or unfinished business, in relation to the Canterbury earthquakes – $15.4 million has been paid to Waimakiriri District Council and $201.5 million to Christchurch City Council. It is Civic Assurance which is still involved in legal proceedings with underwriters but all the LAPP liabilities have been met and there is no on-going matter yet to be settled. The LAPP disaster fund is a charitable trust which is completely separate from Civic Assurance, which merely administers the fund on behalf of the trustees.

7.4 The earlier report to Council noted that the limit provided by the LAPP disaster fund is for a pan-New Zealand programme to include risks in large urban centres such as Lower Hutt and Tauranga, whose risk profile is significantly higher than that for Rangitikei. However, contributions sought from members are determined by their *individual* risk profiles, not the overall limit. The effect of this is potentially advantageous to members like Rangitikei: if a disaster exceeded that calculated in our risk profile, the fund would meet that (up to the overall limit), despite our contribution being for a lower sum.

7.5 Since July 2009, the Council's contributions to LAPP have been as follows:

2009/10	$36,252	No contingent liability
2010/11	$36,252	No contingent liability
2011/12	$145,030	No contingent liability
2012/13	$58,600	Contingent liability of 5 times the annual contribution, limited to two calls in any one year
2013/14	$70,000	Contingent liability of 4 times the annual contribution, limited to two calls in any one year.

7.6 The projected contribution for 2014/15 is $70,000 – but, as noted above, there is no contingent liability.

7.7 If no major event occurs to a member of LAPP in the next few years, the size of the fund will increase, the level of reinsurance (and its cost) will diminish, and the contribution required will fall. In that scenario, insurance premiums would also be likely to fall, although perhaps to a smaller extent; however, it is not possible to project the relative movements with any certainty. Similarly, there would be little foundation to say retrospectively what insurance premiums would have been over the past five years (or, particularly in 2011/12, what level of cover would have been available). Any potential difference in capability of Aon or the LAPP Disaster Fund to secure reinsurance has not been assessed.

7.8 In the end, the choice is firstly on the different cash amounts required for 2014/15 and secondly on the principle of continuing to contribute to a mutual fund compared with relying on an insurance broker used for other aspects of Council's business.

7.9 Whichever option is chosen, the 60% contribution from Government is secure. The final figures for either option will not be determined until the updating of Council's infrastructure records is complete and been taken into account.

8 Recommendations

8.1 That the report 'Options for insuring Council's below-ground infrastructure assets – further consideration' be received.

EITHER

8.2 That Council withdraws the notice of intention to withdraw from the LAPP Fund for 2014/15 (acknowledging that the exact contribution to LAPP in 2014/15 for Council's below ground infrastructure assets has yet to be determined on the basis of updated infrastructure records).

OR

8.3 That Council confirm its notice of intention to withdraw from the LAPP Fund from 1 July 2014 and approves the placement of insurance for Council's below-ground infrastructure assets with Aon (acknowledging that the exact premium for 2014/15 has yet to be determined on the basis of updated infrastructure records).

Michael Hodder
Community & Regulatory Services Group Manager