

DRAFT 16/12/04

Insurance Cost Sharing Schedule – Explanatory Note

1. The Insurance Cost Sharing Schedule ('ICSS') is to be treated as forming part of SoPC3 and SoPC NI.
2. Whilst an Authority may elect not to provide relief for changes in insurance costs, should it wish to do so, then the ICSS is the mechanic which should be used.
3. In such circumstances, the ICSS should be included in the ITN documentation, and agreed with the relevant party prior to award of preferred bidder status.
4. The ICSS anticipates a sharing threshold of 30% of increased or decreased costs and a bi-annual Review Period.
5. The lower threshold will enable Authorities to benefit from falls in insurance costs, in the event that the Authority is procuring a project at a time when insurance costs are at a high point in the insurance cycle.
6. At ITN Authorities may wish to invite variant bids based on a higher threshold of up to 50% and/or a longer Review Period of 3 years. This will be particularly relevant where insurance costs represent a relatively low percentage of the unitary charge (i.e.) less than 10%.
7. Based on previous experience, a Review Period which is longer than 3 years, and/or a threshold which is higher than 50% may not necessarily improve VfM.
8. The ICSS does not provide relief for changes in insurance costs which are attributable to changes in insurance premium tax (IPT). IPT is considered a commercial risk for the Contractor in the same way as corporation tax.
9. The ICSS does not provide relief for changes in insurance costs which are attributable to changes in insurance intermediaries' fees and commissions.
10. In the event that there is either an Insurance Cost Increase or an Insurance Cost Decrease then the Authority's share should always be limited to 85% of any Increase or Decrease. This will ensure that, in the event of an Increase, the Contractor will remain incentivised and focussed on seeking to reduce premiums at each renewal. (Note: the contractors liability will nonetheless be limited given the uninsurability protection available in SoPC3 and SoPC NI should insurance no longer be available on a commercially viable basis.)
11. The appointment of a preferred bidder will typically occur a few months prior to Financial Close. The Modelled Required Insurance Cost (but excluding all construction related insurance costs expected to arise during the construction phase which should be fixed shortly before Financial Close) should be agreed

between the Authority (in conjunction with its insurance advisor) and the relevant bidder prior to the preferred bidder status being awarded. There should be no variation to the operational phase related insurance cost assumptions after the appointment of a preferred bidder.

12. Factors taken into account in the cost sharing calculations comprise:-
 - a. market-wide changes (i.e. if UK insurer, then changes generally prevailing in the UK insurance market) and
 - b. portfolio cost savings.
13. Portfolio cost savings are savings which may arise in the course of the operational period, as the PFI market matures and becomes less fragmented. Specifically, contractors who may have set the modelled cost of insurance on the basis of a single project placement, may in the course of the operational period elect to effect insurance on a portfolio basis. This may give rise to significant cost savings. Given the relatively low threshold and short Review Period anticipated, it is deemed appropriate that if there are savings (beyond the threshold) from this approach, then the Authority should also benefit from the reduced costs.
14. On account of the correlation between contractor performance and insurance premiums, changes in insurance costs which are attributable to the actions of the Contractor shall not be taken into account.
15. Changes in insurance costs which are sector specific shall not be taken into account. The insured peril contributing to the adverse movement in insurance costs should, where possible, be addressed at the individual project level, for example through improved risk management.
16. The periodic review is mandatory.
17. Given the risk sharing provisions, there is a need for greater transparency with respect to insurance costs. At each review it will be important for a report to be provided by the Contractor's insurance broker. This should, inter alia, provide an assessment of the reasons for the changes in insurance costs for each of the main insurance covers and state the level of variation between the modelled and the actual insurance costs. The bidder's financial model should contain a detailed breakdown of all insurance costs in order to assist with this process.
18. The Contractor shall bear the cost of the report provided for each review.
19. The Contractor shall permit the Authority to share at any time the contents of the report with HMT and/or any of its agents and delegates.