

eNews from GAD

Actuarial analysis from the public sector

Issue 21, September 2015



Welcome to eNews – GAD's regular newsletter. A core part of GAD's strategy and values is to be agile and flexible in working to meet evolving client needs. For this reason we have recently made changes to GAD's actuarial teams: more details below.

The insurance industry helps individuals and organisations by facilitating solidarity, enabling risks to be pooled and the costs shared more evenly and predictably. Actuaries are skilled at advising insurers about the pricing and management of the risks. In this issue, Aidan Smith gives an overview of the role of the NHS Litigation Authority and the nature of their work handling claims against, and providing risk management services to, public sector organisations within the NHS. GAD's actuarial and insurance expertise helps NHS LA to price their services and manage the financial obligation of meeting claim costs in the future.

Another example of our flexibility is our history of GAD staff being seconded into our public sector clients' teams. Jack Errington describes his recent secondment with the Department for Education.

I hope that you enjoy this issue; previous issues of eNews are available on our website www.gov.uk/gad.



MARTIN CLARKE, GOVERNMENT ACTUARY

NEWS FROM GAD

Contingent liabilities symposium

The latest Whole of Government Accounts highlights that a close review of contingent liabilities, particularly financial guarantees, is 'crucial for effective management of the public finances'. GAD will be holding a contingent liabilities symposium on Tuesday, 1 December 2015. This breakfast event will include speakers from HM Treasury, the National Audit Office and GAD. The event will be an opportunity to share insights and learn about current thinking. To register interest in this event, please contact lauren.walters@gad.gov.uk.

GAD public service pension scheme conference

Actuarial valuations of the 20 main public service pension schemes were carried out as part of a coordinated and consistent project for the first time as at 2012. This September 2015 event, attended by many schemes and HM Treasury, helped to create common understanding of the next (2016) round of valuations and prepared attendees for the new challenges ahead.

DEVELOPMENTS

Public sector exit payments

HM Treasury has published the government's [response](#) to its July [consultation](#) on proposals to introduce a cap of £95,000 on the total value of public sector exit payments made to an individual. Largely unchanged from the consultation proposals, the cap will apply to the aggregate value of all forms of exit payments including, for example, cash lump sums on redundancy and the cost to the employer of funding early access to unreduced pensions. The government plans to legislate for these proposals through the [Enterprise Bill](#) and supporting secondary legislation.

Assessing the employer covenant

The Pensions Regulator (tPR) has [published](#) new guidance and resources for trustees of Defined Benefit occupational pension schemes on assessing and monitoring the employer covenant. This is the first of a planned series of tPR guidance documents, intended to help trustees apply its Code of Practice on [Funding Defined Benefits](#).

Actuarial team changes at GAD

Following the launch of the new GAD strategy, we have taken the opportunity to review team structures bringing together similar teams to provide focus and clarity to the key areas of GAD's work whilst maintaining our closeness to our clients. This includes:

- unfunded public sector and local government pension schemes under Sue Vivian as Head of Public Sector Pensions
- insurance, investment, risk and modelling work under Aidan Smith who now also has a role as Head of Technical and Professional
- Ian Rogers leading specifically on new opportunities as Head of Business Development; and
- Matt Wood leading further consistency and efficiency improvements as Head of Actuarial Services.

We wish Sue, Aidan, Ian and Matt all the best in their new roles which will be carried out alongside their client advisory positions. By bringing our specialities together in this way we aim to make a smooth transition to better serving our clients going forward.

Barriers to accessing pension flexibilities

HM Treasury has published a [consultation](#) considering how to address possible barriers, such as excessive early exit penalties, to consumers accessing the pension flexibilities first announced at [Budget 2014](#). The [Financial Conduct Authority](#) and tPR have simultaneously carried out comprehensive evidence gathering exercises. HM Treasury plan to publish a response in the autumn.

Review of the Office for Budget Responsibility

HM Treasury has [published](#) a review of the Office for Budget Responsibility (OBR) which finds that the OBR has made substantive progress in improving the credibility of the UK's fiscal framework and comments on the OBR's strong reputation among stakeholders and the increased transparency of forecasts. Whilst not expanding the OBR's remit, the review recommends certain changes to the OBR's core duties and governance framework. Robert Chote has been [re-appointed](#) as Chair of the OBR.

MANAGING NHS LITIGATION COSTS

The NHS Litigation Authority (NHS LA) is an important part of the NHS. Its remit includes the provisions of indemnity cover for legal claims against the NHS and supporting the NHS bodies in learning from claims. GAD provides actuarial support to the NHS LA, combining GAD's technical skills in relation to insurance business with its public sector focus. This article explains how the NHS LA operates and describes GAD's role.



Aidan Smith

What is the NHS LA?

The NHS LA operates five 'pay-as-you-go' risk pools (schemes) covering:

- clinical negligence claims, which comprise around 95% of total claim costs
- employers' and public liability claims from NHS staff, patients and members of the public. Such claims range from slips and trips to bullying, stress, industrial disease and professional negligence; and
- property claims, covering 'first party' losses for material damage to buildings and contents from a variety of causes, including fire, theft and water damage; and also business interruption expense cover arising from property damage.

The NHS LA manages legal claims against the NHS LA on behalf of its members. It aims to settle justified claims fairly and quickly, and to defend unjustified claims robustly in order to protect NHS resources. It helps the NHS to manage risk and reduce future claims by sharing learning from past claims and by determining members' contributions to the schemes on a risk-related basis.

The NHS LA provides services to all bodies providing secondary care services as the NHS in England (members). Since April 2013, the NHS LA has provided indemnity cover directly to independent sector providers of NHS care. The NHS LA does not cover GP and dentist surgeries, or NHS bodies in other parts of the United Kingdom, which have separate arrangements.



Photo by Daniel Sone

How is the NHS LA financed?

The NHS LA is a not-for-profit body. As part of the NHS, it operates on an annual pay-as-you-go basis. This means that, each financial year, it is required to collect sufficient contributions from its members to cover its expected claim costs and expenses (except for some legacy claim costs, which are met directly by the Department of Health). Claim costs comprise damages paid to claimants, as well as the legal costs of defending claims and claimants' legal costs.

Members pay contributions to the schemes each year. As an example, a member's contributions in respect of clinical negligence cover will depend on factors including:

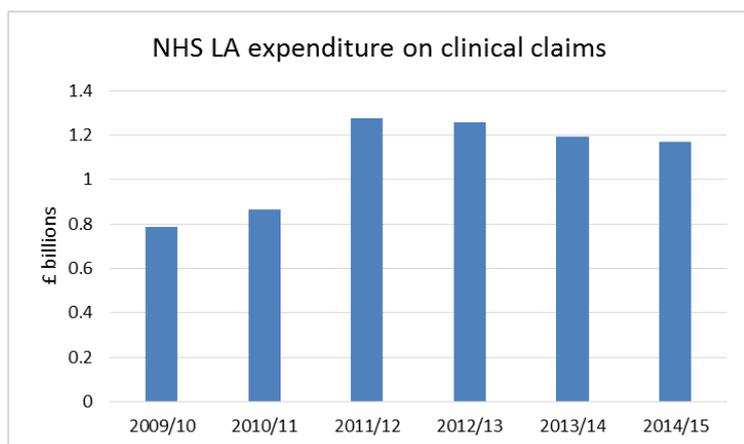
- its size (in terms of staff numbers, and the number of clinical procedures carried out)
- the types of clinical procedures carried out; and
- its previous claims experience.

Member contributions are analogous to insurance premiums paid in return for indemnity cover under traditional general insurance arrangements. In accordance with the pay-as-you-go financing basis, member contributions are required, in aggregate, to cover the scheme's costs during the relevant financial year. By contrast, the premiums charged by private-sector insurers are set to cover the expected cost of claims resulting from events in the year of coverage, regardless of when those costs are paid.

'The NHS LA manages legal claims...on behalf of its members. It helps the NHS manage risk and reduce future claims.'

MANAGING NHS LITIGATION COSTS (continued)

The NHS LA reports its liabilities in respect of future claims expenditure, where the relevant incident has already occurred, but where the claim has not yet been reported to the NHS LA, settled or fully paid. Such provisions totalled £28.6 billion in March 2015, of which 99% was in respect of clinical claims. Expenditure on clinical claims in 2014/15 was almost £1.2 billion. The chart below shows further information on recent clinical claims expenditure.



GAD's role

GAD provides actuarial analysis and support to the NHS LA on the following areas in particular:

- calculation of member contributions for each scheme
- calculation of provisions for expected future payments arising from past events (including advising on appropriate assumptions to use for this purpose); and
- projection of the schemes' future costs.

Such work requires the application of actuarial technical skills appropriate to the different classes of business covered by the NHS LA's schemes.

The NHS LA differs from standard insurance business in a number of ways, including the scale of coverage, claim types, public sector financing arrangements and political considerations. GAD uses its experience of being within and advising the public sector to focus its advice on the NHS LA's specific circumstances.

Case study – Periodic Payment Orders (PPOs)

An increasing number of claims are being settled with some of the damages being structured as Periodic Payment Orders (PPOs). This is where part of the compensation is paid as a stream of annual (or other periodic) payments to the claimant for the rest of their life, rather than as a one-off lump sum payment. It tends to be the largest claims which are settled with structured periodic payments.

The effects of this trend on the financial management of the NHS LA include:

- a reduction in short-term costs, as large, immediate lump sum payments are being replaced by the commencement of a series of periodic payments
- an increase in the NHS LA's provisions for future costs, with the NHS LA being required to pay periodic damages payments for many years into the future in respect of past incidents; and
- increased uncertainty in the NHS LA's provisions for future costs, as the ultimate cost of periodic damages payments will depend on the claimant's longevity, among other factors.

GAD analyses PPO claims separately from other claims in order to reflect the different characteristics of such claims.

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Other insurance work

GAD provides insurance-related advice to a number of other public sector organisations, utilising its experience of actuarial techniques in the insurance industry and its knowledge of the insurance market. For example, GAD advises public sector bodies on the reasonableness of insurance costs for various risks. If you are responsible for managing risks or insurance costs at other organisations, GAD may be able to help you. Please contact us to find out more.

GAD SECONDMENT: FLEXIBLY MEETING OUR CLIENT'S NEEDS

GAD has a track record of providing high quality secondees to other government departments and public sector organisations to work in both traditional actuarial and also financial modelling roles. Our staff are skilled in interpreting complex datasets; developing, implementing, maintaining and/or refining financial models; and communicating results to best support your organisations decision making processes. We also have extensive depth and breadth of knowledge in pensions, demography, financial risk and insurance. This can be a good fit where clients identify a need for staff with these skillsets on a short term basis.



Jack Errington

Jack Errington was recently seconded to the Department for Education (DfE) for six months to assist with a range of modelling projects. Below he discusses why the secondment came about, gives an overview of the projects he worked on and the outcome of the secondment.

The reason for the secondment

The secondment came about due to an urgent short-term need for additional analytical resource within one of DfE's teams of analysts. The other analysts within the team are members of the Government Operational Research Service (GORS) whose expertise shares a lot of similarities with the skills of GAD actuaries, including data analysis, model building, quality assurance, and communication of results to senior colleagues.

The role

I was asked to lead on the analytical strand of a project looking at policy options for the reform of education funding. Additionally, I assisted with the regular work of the team, for example

- Costings of manifesto commitments in the run-up to the general election
- Forecasts of DfE spending for spending review negotiations
- Ad-hoc analysis for ministerial briefings and submissions.

The main project: education funding reform

The current method of allocating revenue funding (for day-to-day running costs such as teachers' salaries) from DfE to local authorities is widely considered to be unfair and lacking transparency as it is based on historic allocations rather than the current characteristics of pupils and schools in each local authority. As a result, the current system can lead to large disparities nationally. For example, the same school would receive over 50% more funding if it was located in Hackney than it would if it was located in Barnsley.

The government made a manifesto commitment to 'make schools funding fairer'. One option being considered to achieve this is introducing a National Funding Formula (NFF). As a simplified example, a school's core budget could be calculated using a NFF which allocates £4,000 per pupil, plus £1,000 per pupil in receipt of Free School Meals, plus £500 per pupil with English as a second language.

My focus was on the High Needs funding block which is for the education of young people with high-cost special educational needs and disabilities (SEND) between the ages of 0 to 25. As well as allocating funding where it is needed, a High Needs NFF needs to avoid creating incentives for schools and local authorities to over-identify the number of young people with SEND or overstate the level of their needs in order to attract more funding.

The project outcome

I led on work to model the impact of different NFFs on each local authority's High Needs funding. The work built on DfE commissioned research into High Needs funding which identified a range of factors that might be appropriate for use in an NFF due to their correlation with levels of SEND.

The results of this modelling are now being fed into discussions with policy colleagues, stakeholders and ministers.

If you are part of an organisation that needs to temporarily expand its team with staff with analytical skills or industry knowledge and expertise, then we may be able to help. If you would like to discuss the possibilities further then please contact your usual GAD advisor or our enquiries address below.

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For details of our management team and office address please visit:

<https://www.gov.uk/government/organisations/government-actuaries-department#people>

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