



# Insurance Guidance for PFI Projects



Insurance premium risk sharing mechanism in PFI projects

# Foreword

**The IPA is pleased to introduce this Guidance Note on the Insurance Premium Risk Sharing mechanism in PFI Projects. This note has been developed by the Infrastructure and Projects Authority (IPA) to provide greater clarity for parties to PFI contracts with Insurance Premium Risk Sharing Schedules (IPRSS).**

The insurance premium risk sharing mechanism, introduced in 2004/05, was a welcome policy addition considering the circumstances prevailing at the time. Given the long-term nature of PFI contracts, the IPRSS provided some degree of certainty for contracting parties with the intention of providing an element of protection during extreme market movements.

The insurance market is inherently cyclical, however overall, since the mid-2000s insurance costs have fallen significantly, resulting in larger savings which should have been shared in line with the sharing mechanism. Over recent years there has been a move away from the original intent of the sharing provision with appointed insurance brokers determining that there is no exceptional saving to be shared with the public sector despite there being sizeable savings from the difference between base cost (which is an agreed estimate fixed at the time of Financial Close) and actual cost.



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Contracting authorities (public sector) have not always fully understood the IPRSS and the required Joint Insurance Cost Reports (JICRs) as there has been a lack of consistency in the way the reports have been presented.

In recent years, this has resulted in a substantial number of disputes surrounding JICRs which have led to a number of these being referred to adjudication. These disputes have used up significant resources, time and cost for contracting parties involved in PFI projects.

Drawing on the outcomes from recent adjudications and independent adjudicators' decisions, this guidance note sets out a framework for Authorities, Contractors and insurance brokers to effectively operate under the IPRSS.

The guidance note is designed to promote best practice, reduce disagreements and provide a solid foundation for the application of the IPRSS when read alongside the relevant version of Standardisation of PFI Contracts (SoPC) but this guidance may also be of use to projects that signed prior to December 2005.



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# Introduction

1. The Infrastructure and Projects Authority has been aware for some time of disputes arising on a number of PFI projects over agreement of Joint Insurance Cost Reports ('JICRs'). In recent years, some of these disputes have been referred to adjudication pursuant to the dispute resolution procedure set out in the relevant Project Agreement. There is a large degree of commonality across the disputes taken to adjudication, both in terms of the issues raised and the decisions reached by the different adjudicators.
2. The purpose of this note is to set out some key principles to guide Authorities, Contractors and insurance brokers in operating the relevant contractual mechanism, known as the Insurance Premium Risk Sharing

Schedule ('IPRSS'). The guidance has been informed by the outcomes of the recent adjudications and the approach taken by the independent adjudicators to key issues of interpretation of the IPRSS provisions. The guidance seeks to establish best practice in relation to JICRs, thereby supporting parties in their application of the relevant provisions and minimising disagreement.



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- 3.** This note is structured as follows:
  - 3.1.** Part 1 provides some background to the insurance cost sharing arrangements in PFI projects;
  - 3.2.** Part 2 explains key elements of those arrangements in more detail;
  - 3.3.** Part 3 sets out key principles underpinning interpretation of the relevant contract provisions;
  - 3.4.** Part 4 contains guidance in relation to the role of the insurance broker and the broker's duty of care to the parties;
  - 3.5.** in Part 5, consideration is given to Market Movement Data and the relevance and appropriateness of any insurance market indices available.
- 4.** Appendix 1 to this note contains an example of a model form Joint Insurance Cost Report. Although the precise drafting of each JICR will vary and is ultimately a matter for the broker producing the report, IPA recommend the use of this example form as the basis of JICRs.
- 5.** Appendix 2 contains worked examples demonstrating the application of the arrangements described in Part 2.
- 6.** The advice provided in this note is guidance only but IPA encourage Authorities, Contractors and insurance brokers to adopt the approach set out in this note.
- 7.** Not all PFI projects will contain the IPRSS. For example, projects dating from before 2005 (and Scottish DBFM/NPD contracts after 2010) may not include insurance cost sharing arrangements along the lines of the IPRSS. Parties should check their specific Project Agreements to ascertain whether this note is of relevance to them.
- 8.** Capitalised terms used in this guidance note are as defined in Standardisation of PFI Contracts Version 4 ('SoPC').

# Key recommendations from this guidance

9. Parties to PFI projects should take account of this guidance and the decisions that independent adjudicators have reached in relation to disputes about the IPRSS.
10. Authorities should ensure that the JICR process provided for in the Project Agreement is carried out in a timely manner. While the Contractor's insurance broker will prepare and issue the JICR, it is the Contractor who has the obligation under the Project Agreement to ensure that this is done.
11. The Project Agreement will set out what should be included in the JICR and on each project all parties should ensure they are familiar with the specific provisions of their agreement (and it may be helpful to set out the IPRSS provisions in the JICR). Parties should in particular familiarise themselves with the exact definitions of Required Insurances and Relevant Insurances and must understand the difference between them.



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**12.** Authorities should check that a Broker's Letter of Undertaking (BLOU) is in place with the Contractor's insurance broker – and if it is not, require the Contractor to put one in place as a letter should be issued upon a change of broker and upon each renewal of insurance – and take appropriate steps to ensure the broker is fully aware of its duties to the Authority as specified in the BLOU. Any deviation from the wording in the draft in the Project Agreement should only be minor and any limit on liability being inserted into the BLOU should be proportionate to the amounts of cover being placed.

**13.** An Authority should carefully review each JICR received and take expert advice if in any doubt about the accuracy or correctness of it. The contract provisions governing the IPRSS are complex and understanding them fully requires a degree of both legal and insurance expertise which Authorities may not have in-house.

It should be possible for Authorities to obtain a high-level expert view quickly and at a relatively low cost.

**14.** Authorities must act quickly in this regard. Standard drafting gives Authorities only 15 Business Days to object to JICRs once they are received. If objections are not lodged within that timeframe, setting out the details of any disagreement, the Authority will be deemed to have accepted the JICR in question.

**15.** In preparing and reviewing JICRs, brokers, Contractors and Authorities should:

- have regard to the recommended application of the IPRSS drafting described in this guidance note
- ensure that any insurance market movement data (including any index referred to) relied upon in a JICR is credible based upon the criteria set out in Part 5 of this guidance note

- ensure that the information supplied is sufficiently detailed and comprehensive in order for the reader to have a clear understanding of how the premiums have been calculated

**16.** In preparing JICRs, brokers should follow the approach of the model form JICR in Appendix 1 unless there is a good reason not to do so.

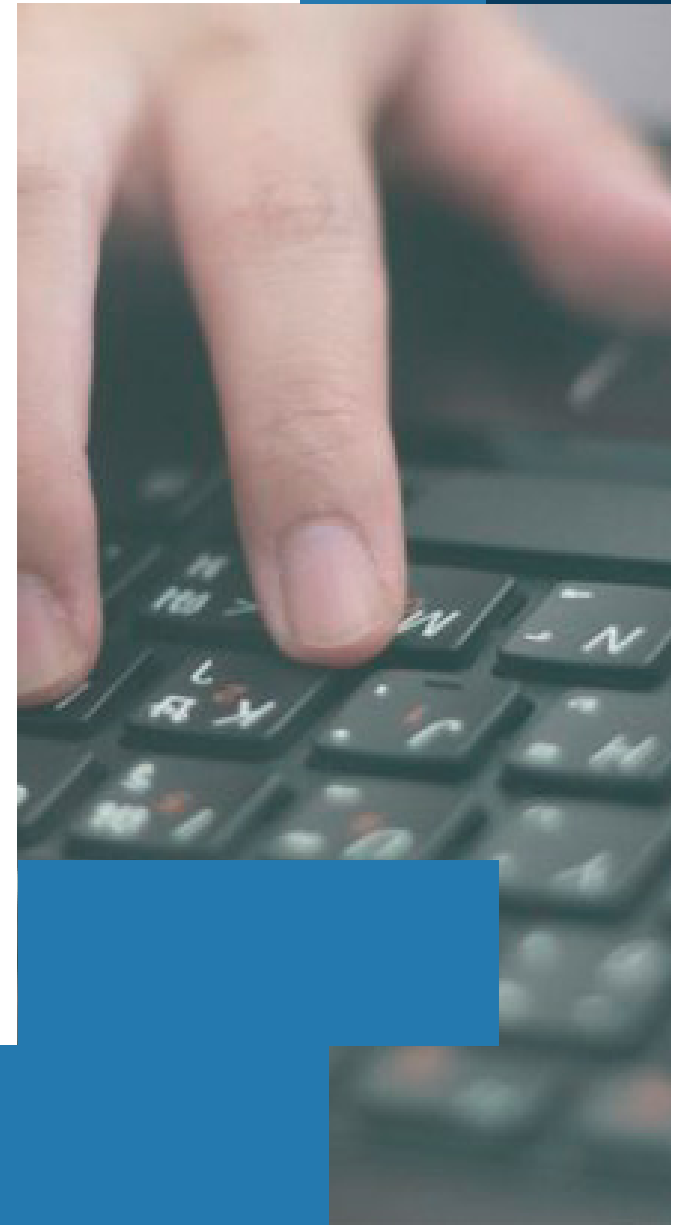


# Part 1 – Background

17. Many PFI Project Agreements include arrangements through which increases and decreases in insurance premium costs over time can be shared between the Authority and the Contractor.
18. In the vast majority of cases, the provisions governing these arrangements will be identical, reflecting the standard wording set out in section 25.8 of SoPC – the IPRSS.
19. Fundamentally, the IPRSS requires a two-yearly comparison of the actual insurance costs incurred by the Contractor against the amounts the Authority is paying in respect of insurance costs through the unitary charge. This consists of a fixed base cost (expressed in real terms) forecast by the Contractor in its bid for the

purposes of the sharing regime and subsequently set out in the Project Agreement, adjusted for indexation.

20. The biennial cost comparison is carried out by the Contractor’s insurance broker, who produces an analysis called a Joint Insurance Cost Report. The JICR sets out various details relating to insurance premium cost, and states whether there must be any sharing of costs or savings based on application of the IPRSS provisions in the Project Agreement. Each JICR must be agreed by the Authority, though, as noted in paragraph 14 above, Authorities have a limited period within which to approve or reject JICRs.



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- 21.** If the Authority does not agree with any aspect of a JICR and the parties are unable through their reasonable endeavours to resolve the matter within a set period, there is provision for the contents of the JICR to be referred to the formal dispute resolution procedure in the Project Agreement.
- 22.** The approach taken to the sharing of insurance premium costs was standardised by HM Treasury in December 2005. At that time, HM Treasury issued an addendum to *Standardisation of PFI Contracts* version 3 (SoPC3) which contained, amongst other things, standard wording for such arrangements, named the Insurance Premium Risk Sharing Schedule, and associated guidance. The addendum, including the IPRSS, was subsequently incorporated in the next version of SoPC (SoPC4) when it was issued in March 2007, and can be found at section 25.8 of the same.
- 23.** While inclusion of the IPRSS in PFI contracts was not mandatory, SoPC was clear in stating that if an Authority elected to share insurance cost risk, the only mechanism it would be permitted to use was the IPRSS<sup>1</sup>. In practice, most PFI contracts signed since December 2005 include the IPRSS provisions, and indeed some contracts signed before that date will also include a version of the provisions as they were in development prior to being formally launched in the SoPC3 addendum<sup>2</sup>.
- 24.** The IPRSS was conceived at a time during which there was an unusual degree of turbulence in the insurance market. In those circumstances, questions were raised about whether passing full insurance premium cost risk to the Contractor over the life of a PFI project was the best approach from a value-for-money perspective. Contractors were concerned that insurance costs could potentially increase significantly over time due to market-wide factors beyond their control. The IPRSS therefore offered a way in which such increased costs could be shared, and came with the concomitant requirement that any savings that arose would also be shared.
- 25.** A key principle underpinning the IPRSS, and which is referred to in a number of places in section 25.8 of SoPC, is that the parties should only share the detriments and rewards arising from movements in actual insurance costs (relative to the base insurance costs) where they

<sup>1</sup> SoPC, para 25.8.1

<sup>2</sup> An exception is in Scotland where the SFT standard form DBFM/NPD does not have insurance sharing provisions.

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arise as a result of general market conditions. There is one exception to this – Portfolio Cost Savings – which is considered further below.

**26.** Since the IPRSS was introduced, insurance costs across PFI projects have changed in different ways for different sectors. In a number of sectors, in particular for more standard accommodation-based projects (such as schools and hospitals) costs have typically fallen, in many cases by a significant amount. In other sectors, such as waste, the picture is less clear-cut.

**27.** The IPRSS only covers operational period insurances, which are typically procured on an annual basis. Construction period insurances are excluded from the cost sharing arrangements because they are generally purchased prior to financial close for the whole of the construction phase so there is no risk of cost changes arising from market conditions.



## Part 2 – The IPRSS

**28.** As noted above, the IPRSS requires the Contractor to procure from its insurance broker a Joint Insurance Cost Report every two years, comparing the actual insurance costs incurred by the Contractor against the indexed base cost. This comparison produces a result called the Insurance Cost Differential. If the actual costs are more than 30% higher or lower than the indexed base cost, the excess above or below that threshold is shared between the parties, with 85% going to the Authority and 15% to the Contractor. If the 30% threshold is not reached, the additional costs or savings are entirely for the account of the Contractor.

**29.** Calculation of the Insurance Cost Differential is at the crux of the IPRSS mechanism, and is the principal focus of recent disputes that IPA has reviewed. The consequential calculations from which the actual sum to be shared is derived have not proved controversial in most cases. The relevant definition from SoPC is as follows:

***Insurance Cost Differential = (ARIC – BRIC) – (± PIC)***

***where:***

***ARIC is the Actual Relevant Insurance Cost***

***BRIC is the Base Relevant Insurance Cost***  
***PIC is any Project Insurance Change***

**30.** In respect of the above:

- the Actual Relevant Insurance Cost (ARIC) is the aggregate of actual insurance premium costs incurred by the Contractor over the two-year Insurance Review Period to maintain the Relevant Insurance, excluding insurance premium tax and broker's fees and commissions
- the Base Relevant Insurance Cost (BRIC), as described in paragraph 19 above, is the Base Cost indexed; the Base Cost being a sum specified in the Project Agreement and representing (in real terms) the sums forecast in the base case financial model to be incurred by the Contractor over the Insurance Review Period in relation to the Relevant Insurance. The Base Cost is indexed from the Bid Date up to the

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time the insurances for the relevant Insurance Review Period are taken out or renewed

- the Project Insurance Change (PIC) operates as an adjustment to the ARIC v BRIC differential, to exclude the influence of factors affecting costs that are not market related – it is explained further below

**31.** It is worth noting that the ARIC is the insurance premium costs that relate to the 'Relevant Insurance' only; i.e. they are not the costs relating to *all* the Contractor's insurances. Certain categories of insurance cover are expressly excluded from the definition of Relevant Insurance, and as such the premium costs relating to such cover

should be excluded when calculating the ARIC. On most projects the impact will be minimal, but in other cases a failure to limit ARIC to costs relating to the Relevant Insurance alone can have a significant effect on the outturn numbers.<sup>3</sup> All parties must scrutinise and familiarise themselves with the specific definitions of 'Required Insurances', 'Relevant Insurances' and 'Unavoidable Fixed Costs' in their Project Agreement.

**32.** The third element in the calculation of the Insurance Cost Differential is the Project Insurance Change (PIC). The purpose of the PIC element is to adjust the ARIC v BRIC differential, so as to negate the influence of

certain factors ('PIC factors') that would otherwise have affected it. PIC factors consist of factors other than circumstances generally prevailing in the Relevant Insurance Market and Portfolio Cost Savings and are typically the actions of the Contractor or matters within its control that affect insurance costs. The key principle embodied in PIC is that the only costs or savings arising from movements in the cost of insurances that should be shared are those that arise as a result of changes in insurance market conditions, as opposed to issues or factors arising from actions of the Contractor or matters for which the Contractor is responsible. This is clear from the SoPC guidance, one part of which explains:

<sup>3</sup> As drafted in SoPC, 'Relevant Insurance' excludes (i) construction period insurance and (ii) business interruption cover except to the extent that it relates to Unavoidable Fixed Costs. It is this second point that can be overlooked, such that all premium costs relating to BI cover are included without consideration of whether any portion of them could be said to relate to something other than Unavoidable Fixed Costs (Unavoidable Fixed Costs being certain identified costs of the Contractor which, importantly, include senior debt service but exclude distributions to shareholders). Note that there may be additional project-specific exclusions from the Relevant Insurance – it is always important to check the contract in question.

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### **This insurance cost sharing arrangement is limited to market wide movements and so should not take into account the following:**

- any change in the cost of insurance which, with the exception of portfolio cost savings, is not attributable to a general movement in insurance costs across the PFI market as a whole, (i.e. changes in insurance costs due to circumstances generally prevailing in the insurance market in which the majority of all PFI projects (across all sectors) is placed). Accordingly, changes in insurance costs which are project or sector-specific should not be taken into account
- changes in insurance premium tax; or

- changes in insurance intermediaries' fees and commissions<sup>4</sup>.
- 33.** An exception to this principle, expressly stated in SoPC, is Portfolio Cost Savings. These are savings accruing to the Contractor as a result of it choosing, for a given Insurance Review Period, to include the project within a portfolio of projects for the purpose of obtaining insurance, rather than insuring the project on a standalone basis, the expected result of which is a cost reduction. While such a cost reduction cannot be said to arise from circumstances generally prevailing in the Relevant Insurance Market, it was considered reasonable for Authorities to share in these savings.<sup>5</sup>

- 34.** The definition of Project Insurance Change from SoPC is as follows:

### **Project Insurance Change means any net increase or net decrease in the Actual Relevant Insurance Cost relative to the Base Relevant Insurance Cost, arising from:**

- a. the claims history or re-rating of the Contractor or any Contractor Related Party;
- b. the effect of any change in deductible unless the following applies:
  - i. such change is attributable to circumstances generally prevailing in the Relevant Insurance Market; and

<sup>4</sup> SOPC4, para 25.8.5. It's recommended to review the entirety of section 25.8 of SoPC which should be read alongside this guidance note. The reference in paragraph 25.8.5 to project-specific changes is to PIC factors, as explained in SoPC4 footnote 31. The reference to 'the PFI market as a whole' aligns with the definition of Relevant Insurance Market, and the reference to sector-specific changes needs to be read in that context.

<sup>5</sup> See SoPC4, para 25.8.6 for further explanation of the approach to Portfolio Cost Savings

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- ii. the deductible, further to such change, is either greater than or equal to the maximum in Schedule [ ] (Required Insurance Schedule),
- c. any other issue or factor other than circumstances generally prevailing in the Relevant Insurance Market, except for any Portfolio Cost Saving,

**For the purpose of determining the Insurance Cost Differential, in the event that there is a net increase, the Project Insurance Change shall have a positive value. In the event that there is a net decrease the Project Insurance Change shall have a negative value.**

35. Appendix 2 sets out worked examples illustrating the operation of PIC. The purpose of these examples is to demonstrate how PIC will affect the calculation of the Insurance Cost Differential. The examples take as a

starting assumption that a PIC exists. However, as will be evident from this guidance note, whether a PIC exists will be a question of fact in each case, and any PIC that is claimed in a JICR will have to be justified. In most cases, IPA would expect there to be no PIC.

36. The IPRSS provisions set out certain items that must be covered in each JICR<sup>6</sup>. Amongst other things, these include: *'an assessment and quantification of each Project Insurance Change together with the reasons therefor'; 'full details of any Portfolio Cost Savings'; 'any other reasons that the Contractor believes may have caused a change (by way of increase or decrease relative to the BRIC) in the ARIC'; 'the opinion of the Contractor's insurance broker as to the reasons why the ARIC has varied from the BRIC, specifying the impact of each of the factors and*

*quantifying the amount attributable to each factor specified above'; 'evidence satisfactory to the Authority (acting reasonably) of any changes to the circumstances generally prevailing in the Relevant Insurance Market that are claimed to account for the Insurance Cost Differential'.*

<sup>6</sup> Clause 2.2 of the template IPRSS drafting

## Part 3 - Interpretation of 'Project Insurance Change'

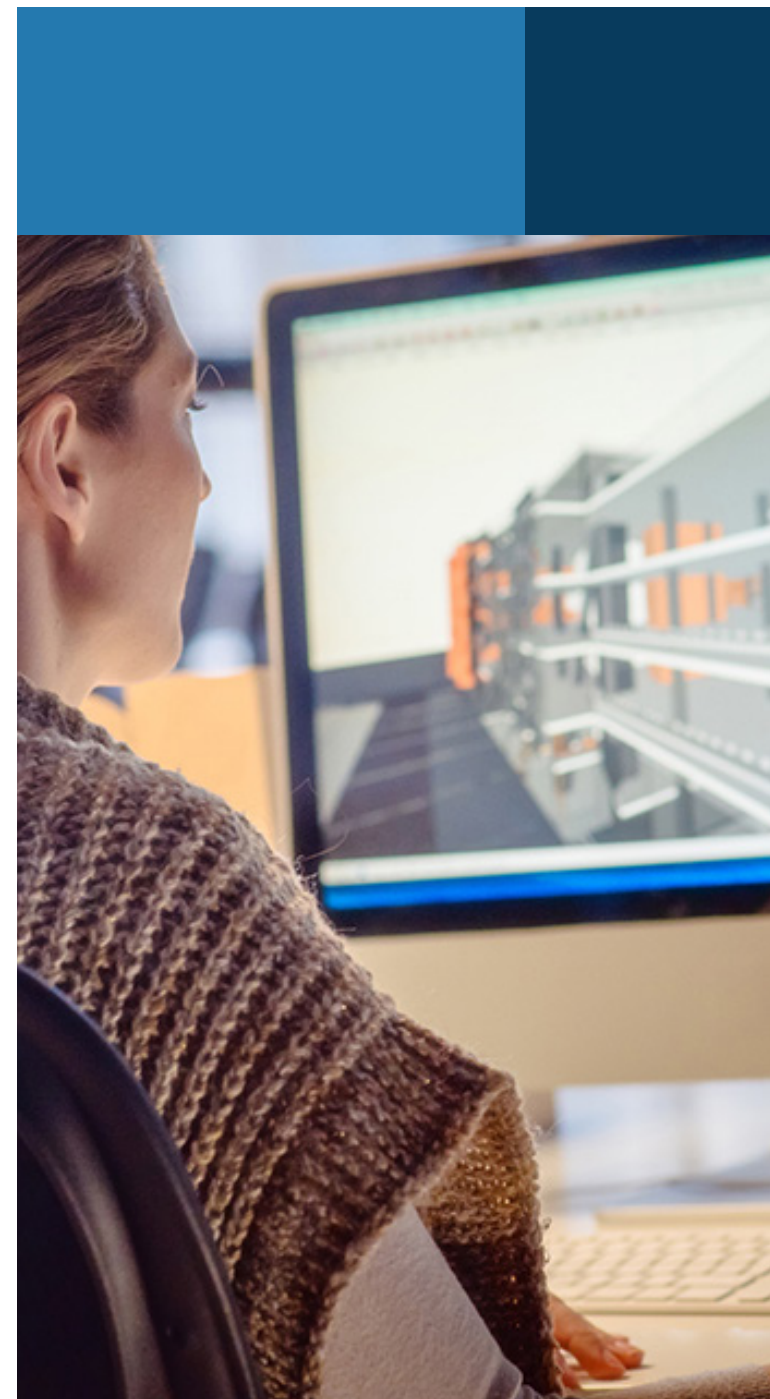
**37.** Interpretation of the 'Project Insurance Change' definition has been a key area of disagreement across the recent disputes between PFI parties regarding IPRSS provisions that have been referred to adjudication. Set out below are a number of principles to be followed by all parties involved in producing and reviewing JICRs – namely insurance brokers, Authorities and Contractors.

### **Principle 1 - 'PIC' is the aggregate of identified and quantified 'Project Insurance Changes'**

**38.** For the purposes of calculation of the Insurance Cost Differential, the PIC is the net sum of increases and decreases in the BRIC v ARIC differential that are

attributable to separately identified and quantified Project Insurance Changes. As noted above, the IPRSS provisions require the broker producing a JICR to include within that report 'an assessment and quantification of each Project Insurance Change together with the reasons therefor'.

**39.** It follows that the overall PIC value, used in the Insurance Cost Differential calculation, is the aggregate of the impacts arising from each separately identified and quantified Project Insurance Change (if any). If a JICR fails to identify, and quantify the impact of, individual Project Insurance Changes, the value of PIC must be nil.





**40.** Examples of genuine Project Insurance Changes are given in the definition of the same, namely the claims history of the Contractor and changes in deductibles. Other events that might constitute a Project Insurance Change include changes in the risk profile of the project that have not involved a variation of the base cost<sup>7</sup>. Ultimately, whether a particular event can be considered a Project Insurance Change, and if so the impact of that event upon insurance costs, will be a matter of evidence and will depend upon the circumstances.

### **Principle 2 – The PIC analysis is concerned with the factors that have had an impact on the ARIC v BRIC differential in the relevant Insurance Review Period.**

**41.** PIC is concerned with the factors which influence (increase or decrease) the differential between ARIC and BRIC in the relevant Insurance Review Period, as explained in the first sentence of the definition of PIC in SoPC as reproduced in paragraph 34 above. The exercise to be performed is to identify, differentiate between, and quantify, the effect/influence of PIC factors and non-PIC factors (general market conditions and Portfolio Cost Savings) on the ARIC v BRIC differential. PIC factors are elements that have influenced the size

of the differential; however, they are not the *only* elements that influence the ARIC v BRIC differential. Different ways in which a PIC factor may influence the ARIC v BRIC differential are shown in Appendix 2. As BRIC is fixed<sup>8</sup> before ARIC is in existence, it follows that increases/decreases in the ARIC v BRIC differential in any Insurance Review Period can only be produced by issues or factors that affect ARIC. Therefore the focus should be on accounting for the value of ARIC.

<sup>7</sup> If such changes constitute a Variation then the Base Cost should have been recalibrated so as to maintain a constant risk profile, therefore this will not constitute a Project Insurance Change.

<sup>8</sup> The Base Cost expresses the Contractor's projection in real terms at a given date; BRIC expresses the same value in nominal terms, as explained in paragraph 19.

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**42.** On every project the ARIC that applies when the operational insurances are first placed inevitably diverges from the BRIC. This was fully anticipated by SOPC – paragraph 25.8.1 states the Base Costs will *‘invariably differ from the prevailing cost of insurance at the Bid Date’*. This divergence arises simply as a result of bid pricing not accurately predicting costs at the time the insurances are placed, which may be intentional or inadvertent. SOPC is clear that savings or excess costs resulting from inaccuracy of the Contractor’s Base Costs projection will be shared.<sup>9</sup> This makes sense. This day-one differential (the difference between the first ARIC and the BRIC at that date) cannot be a PIC. It is a product simply of the relevant values of BRIC and ARIC, and has not been influenced by any PIC factor.

Indeed, as BRIC was determined at the bid date,<sup>10</sup> before ARIC is in existence, increases/decreases in the ARIC v BRIC differential in any Insurance Review Period can only be produced by issues or factors that affect ARIC. That is not the case when it comes to the inevitable day-one differential.

### **Principle 3 – Good risk management is not usually a PIC**

**43.** It is clear that the concept of ‘Project Insurance Change’ will capture changes in insurance costs attributable to the actions of the Contractor.<sup>11</sup> IPA are aware of JICRs in which the authors have sought to establish that the good risk management practices adopted by the relevant Contractor constitute a PIC factor, and that the savings resulting from them should therefore

be included in the overall PIC value, thereby falling outside the sharing ‘pot’. Examples IPA have seen include: good claims history, existence of quality facilities management and health and safety regimes, implementation of insurer’s recommendations, use of a specific broker.

**44.** This line of reasoning is flawed. Authorities are entitled to expect their Contractors to adopt a high standard of risk management as a matter of course (and will be paying for such under the unitary charge), and therefore the adoption of such measures in practice will not result in a net decrease in actual costs relative to base costs.

<sup>9</sup> Para. 25.8.1 SoPC.

<sup>10</sup> The Base Cost expresses the Contractor’s projection in real terms at a given date; BRIC expresses the same value in nominal terms.

<sup>11</sup> See footnote 31, para 25.8.5 SoPC.

**45.** That is not to say that good risk management practices can *never* be a PIC factor. If a Contractor takes steps that go beyond standard good practice, which result in a demonstrable reduction in insurance costs, this will constitute a PIC factor. Equally, poor risk management by a Contractor, resulting in increased insurance costs, can be considered a PIC factor. Ultimately this will come down to the circumstances in each particular case and the evidence that is available to support the position taken.

**46.** The fact that there *may* be, on an exceptional basis, examples of particularly good or bad practices that are deemed to constitute a Project Insurance Change, should not detract from the general principle that provision of high quality risk management services by the Contractor is not a Project Insurance Change. This issue

was considered in recent adjudications, and the relevant adjudicators consistently took this view.

### Alternative interpretation

**47.** IPA are aware that an alternative – and incorrect – interpretation of the definition of ‘Project Insurance Change’ has been propounded by certain insurance brokers who have produced JICRs. This interpretation construes the words ‘*net increase or net decrease in the Actual Relevant Insurance Cost relative to the Base Relevant Insurance Cost*’ in the opening lines of the definition as referring to the *overall* difference between ARIC and BRIC. If this interpretation is adopted, the logical conclusion is that the entirety of the BRIC v ARIC differential must be classified as being due to one of (i) Project Insurance Change; (ii) circumstances generally prevailing in the Relevant Insurance Market; and (iii) Portfolio Cost Savings.

**48.** Those preferring this interpretation read limb (c) of the Project Insurance Change definition as a catch-all. On this construction, any amount of the BRIC v ARIC differential that is not attributed to circumstances generally prevailing in the Relevant Insurance Market or to Portfolio Cost Savings must constitute the PIC.

**49.** This alternative interpretation has been considered in the adjudications to date and rejected by the majority of adjudicators.

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**50.** It fails for a number of reasons.

Examples of the difficulties presented by this alternative interpretation are as follows.

**50.1.** It misconstrues the phrase *'net increase or net decrease'* in the ARIC relative to the BRIC (emphasis added). These words make clear that PIC is not concerned with explaining the ARIC v BRIC differential as a whole but rather is focused upon the elements (of which there may be more than one) that have caused the differential to increase or decrease.

**50.2.** The requirement for each JICR to contain *'an assessment and quantification of each Project Insurance Change'* would be redundant – why would it be needed if anything that is not attributable to circumstances generally

prevailing in the Relevant Insurance Market or Portfolio Cost Savings is inevitably considered to be the PIC?

**50.3.** Limbs (a) and (b) of the 'Project Insurance Change' definition would be redundant for the same reason – why are they needed if anything that is not attributable to circumstances generally prevailing in the Relevant Insurance Market or Portfolio Cost Savings is automatically considered the PIC?

**50.4.** The requirement for each JICR to contain details of other reasons the Contractor believes may have caused a change (by way of increase or decrease relative to the Base Relevant Insurance Costs) in the Actual Relevant Insurance Costs would also be redundant.

**51.** Furthermore, if this alternative interpretation of PIC is adopted, the projection inaccuracy referred to in paragraph 42 above would be deemed to be a PIC and therefore not shared, as it does not result from circumstances generally prevailing in the Relevant Insurance Market or Portfolio Cost Savings. As noted previously, the IPA's view, as supported by the majority of recent adjudications, is that this is not what was intended by SoPC, as it specifically refers to the sharing of costs or savings that result from this projection inaccuracy.

## Part 4 – Role of the broker

**52.** In preparing a JICR, the relevant broker owes a duty of care to the Authority.

This is clear from the SoPC provisions, which state that *‘the Contractor’s insurance broker shall prepare a report on behalf of both the Contractor and the Authority’*.<sup>12</sup>

**53.** The ambit of this duty of care is clarified in the Broker’s Letter of Undertaking (**‘BLOU’**). The BLOU is a letter issued by the Contractor’s insurance broker to the Authority which contains a number of undertakings given directly to the Authority, and upon which the Authority can rely. A BLOU should have been provided at financial close, and Project Agreements should include

an obligation upon the Contractor to ensure that further BLOUs are issued when required, which may be when a broker is replaced or upon each renewal of the Required Insurances.

**54.** Authorities should ensure that they hold a BLOU from their Contractor’s existing broker which complies with the requirements of their Project Agreement. If they do not, they should require the Contractor to arrange for one to be provided.

**55.** SoPC contains a template BLOU which includes the following statement from the broker:

**‘...we hereby undertake in respect of the interests of the Authority in relation to the Required Insurances... to prepare following request, at the expense of the Contractor, a Joint Insurance Cost Report on behalf of both the Contractor and the Authority in accordance with the Insurance Review Procedure as set forth in section [X] of the Agreement. We shall ensure that the information in the Joint Insurance Cost Report is fairly represented based on the information available to us.’**

<sup>12</sup> Clause 2.2 of the standard drafting in SoPC paragraph 25.8. See also SoPC paragraph 25.8.11.

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**56.** When preparing a JICR, a broker should be cognisant of the duty of care that it owes to the relevant Authority – as well as the Contractor – and the commitments contained in the BLOU.<sup>13</sup>

**57.** Equally, Authorities need to be aware of this duty, and may wish to take a more proactive approach to ensure a broker's commitments are met, such as reminding the broker of its duty of care at the point work is starting on a JICR, and making clear to the broker that the Authority expects to have a direct point of contact with whom to raise queries or concerns about the JICR.

**58.** However it should be noted that the broker's duty of care only extends to the accuracy of information in the JICR and the role of the broker does not extend to interpreting contractual terms.



<sup>13</sup> Brokers will also be cognisant of their obligations under FCA ICOB rules, including PRIN 2.1.1 part 6 which requires brokers to treat their customers fairly.

## Part 5 – Relevant insurance market movement data and appropriate indices (if any)

**59.** Standard IPRSS drafting in SoPC refers to the concept of the 'Relevant Insurance Market' in two places:

- in the definition of 'Project Insurance Change', as seen in paragraph 34 above
- in an obligation placed on the Contractor to ensure that each JICR contains evidence of changes to circumstances generally prevailing in the Relevant Insurance Market<sup>14</sup>

**60.** In conducting an insurance cost review, therefore, it will be necessary to identify the Relevant Insurance Market. SoPC provides the following definition:

**'Relevant Insurance Market' means the insurance market which insures the majority of all PFI projects across all the PFI sectors (as determined by the number of PFI projects). At the date of this Contract, the Relevant Insurance Market is in [the United Kingdom]**

<sup>14</sup> Clause 2.2.9 of the standard drafting in SoPC paragraph 25.8.



## Insurance Guidance for PFI Projects

- 61.** Where the Project Agreement uses this definition the Relevant Insurance Market will normally be the UK commercial insurance market. This is effectively the same insurance market from which mid-sized UK commercial enterprises obtain their insurances. It is primarily for Material Damage and Liability Insurance and does not include Marine, Aviation, Credit, Reinsurance or other more specialist classes of Insurance.
- 62.** There may be exceptions, where the project is insured in one of the other primary markets referred to in the preceding paragraph. Some projects' definition of Relevant Insurance Market has been adapted to refer to a particular sector – e.g. 'the rail market' or 'the waste market', although no such market is recognised by the UK insurance industry. However, it is generally self-

evident in such cases that the parties' choice of words reflects an intention to identify the market in which the project is insured from time to time, whatever that might be, as the Relevant Insurance Market, and therefore they should be interpreted and construed with that in mind.

- As noted in paragraph 36, SoPC requires each JICR to include evidence *'of any changes to the circumstances generally prevailing in the Relevant Insurance Market that are claimed to account for the Insurance Cost Differential'*.<sup>15</sup> Such market movement data evidence can provide helpful corroboration of other figures presented in a JICR. In particular, it will provide helpful assurance that changes in the insurance costs of a particular project

are in line with the wider market, once project-specific issues have been taken into account.

- 63.** In order to demonstrate changes to circumstances generally prevailing in the Relevant Insurance Market, producers of JICRs may use indices to evidence what may be termed, for convenience, market movement data. IPA have been concerned to note a variation in the quality of market movement data and indices quoted in JICRs.
- 64.** Important criteria of reliable market movement data (or an index) would be:
- transparency – the method and base data used (or used to calculate any index) should be freely available

<sup>15</sup> Clause 2.2 of the template IPRSS drafting



## Insurance Guidance for PFI Projects

- credibility – there should be an element of market acceptability, where the data or index is available to various market participants to review and comment on its credibility
  - appropriateness – the data or index should only relate to the Relevant Insurance Market and not to non-related markets
  - longevity – the data or index should be available for the whole of the operational period of the PFI project in question and there should be no retrospective estimates of what the data or index might have been had it existed, prior to when it was established
- 65.** To provide additional assurance, it may be appropriate to compare more than one set of market movement data or index, provided each of them is suitably reliable.
- 66.** An Authority should pay attention to any market movement data or index quoted in a JICR and seek to identify whether it meets the above criteria. Ideally, the broker should confirm in the JICR that the market movement data or index used satisfies these criteria and provide an explanation or evidence of the same. If the confirmation is absent, Authorities may request it. If there is no existing market movement data or index that completely meets these criteria that should be acknowledged, and an alternative method of explaining movements should be used if at all possible, with explanation as to why the data or index has been selected as the most appropriate and closest available data or index to meeting the criteria set out above.
- 67.** It should be noted that the mere fact that movements in ARIC on a particular project deviate from any relevant index or market movement data will not of itself indicate the existence of a PIC factor, and will not satisfy the requirement that a JICR provide ‘an assessment and quantification of each Project Insurance Change together with the reasons therefore’.
- 68.** SoPC refers to an Insurance Cost Index ultimately being published by HM Treasury for use with the IPRSS<sup>16</sup> but this is no longer a policy objective, which is why this note recommends other credible data to be provided in the JICR as evidence of movement in the Relevant Insurance Market (“Market Movement Data”).

<sup>16</sup> Clause 4 of the standard drafting in SoPC paragraph 25.8.

# Appendix 1:

## Example Joint Insurance Cost Report

**Guidance Note:** *An example (fictitious) Joint Insurance Cost Report is set out below. This is recommended by IPA as representing good practice, and IPA encourage brokers to follow the approach of this example JICR unless there is a good reason not to do so. Of course, the specifics will need to change depending on the circumstances of each case. In particular, the example report below envisages a situation in which 'PIC' is zero and an Exceptional Saving arises. Clearly, this will not always be the case.*

*While IPA recommends this example JICR as a template for brokers, responsibility for production of a JICR rests with the broker that is retained to prepare it. Brokers must prepare JICRs in the manner they see fit, taking account of their professional responsibilities and their duties to each party.*

*It is appreciated that in some cases there will be insufficient historic data available to a broker for them to be able to follow completely all of the steps in this template which are aimed at calculating the most accurate figures of any sharing. However, using reasonable endeavours to follow this 'best practice' guidance note and template report will increase the information available in future and build a comprehensive picture of a project's insurance history over time making subsequent JICRs quicker and easier to produce. In the meantime, all stakeholders should aim to be clear, transparent and detailed in furthering understanding of the project so far, its risks, changes, insurance pricing, etc. to date.*

# Joint Insurance Cost Report

<b>Project:</b>	XYZ schools Ltd
<b>Contractor:</b>	ABC Contractors Ltd
<b>Authority:</b>	Somewhere Borough Council
<b>Review Period:</b>	<b>31st Oct 2020 to 30th Oct 2022</b>
<b>Prepared by:</b>	Good Brokers Ltd
<b>Insurance Review Date:</b>	<b>31<sup>st</sup> Oct 2021</b>
<b>Due date of report:</b>	<b>12th Nov 2021</b> (10 Business Days after the Insurance Review Date)
<b>Actual date of report:</b>	<b>8th Nov 2021</b>
<b>Due date for payment of premium share:</b>	<b>20th Dec 2021</b> (30 Business Days after report)

If the Authority does not agree the contents of this report it must notify the Contractor by **29th November 2021** (15 Business Days after submission of the report)

**Guidance note 1:** *It is recognised that historically many JICRs have (by agreement) been produced at the end of the Insurance Review Period. In the above case this would mean that the report would be produced by the 12th Nov 2022, the Non-Acceptance date would be the 29th Nov 2022 with the Payment date being the 20th Dec 2022. If this is what the parties have agreed, it should be documented as an amendment to the Project Agreement. (See SPoC4 25.8.8).*



# Section 1 Executive Summary

- a. This Joint Insurance Cost Report (JICR) relates to the Insurance Review Period 31<sup>st</sup> Oct 2020 to 30<sup>th</sup> Oct 2022.
- b. In accordance with clause [•] of the Project Agreement, if the Authority does not agree the contents of this report it must notify the Contractor accordingly in writing within [15] Business Days, otherwise the report will be considered to have been accepted. The notification must include the reasons why the Authority does not accept the JICR.
- c. There is an Exceptional Saving, 85% of which is due to the Authority. This amounts to **£202,469**, which should be paid to the Authority by the Contractor by **20<sup>th</sup> December 2021**.

- d. The headline calculations to arrive at the Exceptional Saving and the Authority's share of savings are as follows:

ARIC (A)	£85,000
BRIC (B)	£461,784
PIC (C)	Nil
Insurance Cost Differential (i.e. (A-B) - (+/- C)(D)	-£376,784
<b>Insurance Cost Decrease</b> (i.e. D x -1)(E)	<b>£376,784</b>
30% of BRIC (F)	£138,585
<b>Exceptional Saving</b> (i.e. E - F)	<b>£238,199</b>
<b>Shares of Exceptional Saving:</b>	
Contractor 15%	£35,730
Authority 85%	£202,469

- e. ARIC (the Actual Relevant Insurance Cost) and BRIC (the Base Relevant Insurance Cost) are calculated in Section 4. PIC (Project Insurance Change) is calculated in Section 6. The Insurance Cost Differential, Insurance Cost Decrease and Exceptional Saving are calculated in Section 9.

**Note:** Capitalised terms used in this JICR and not otherwise defined bear the meanings given in the Project Agreement

# Section 2

## Abbreviations and key data

### Abbreviations

Abbreviation	Meaning
<b>ARIC</b>	Actual Relevant Insurance Cost. <i>The Relevant Insurance is different to the Required Insurance, but in most cases, it only impacts Business Interruption and the cost difference is marginal and difficult to calculate, so many JICRs use the premiums to the market (Required Insurances) as the ARIC. In a low number of cases, it makes a big difference.</i>
<b>Gross ARIC</b>	The initial ARIC without Portfolio Cost Savings. <i>This is an artificial construct created for this guide only and does not appear in SoPC4. It is used to try and help with the opinion in Section 8.</i>
<b>BRIC</b>	Base Relevant Insurance Cost. <i>This is the indexed Base Cost which is indexed each year by either RPI or RPIx.</i>
<b>Gross BRIC</b>	This is the BRIC prior to applying a BRIR. <i>This is another artificial construct for this guidance, and given that BRIRs are extremely rare, it will hardly ever be used</i>
<b>BRIR</b>	Base Relevant Insurance Reduction. <i>This is rarely needed but becomes relevant where a deduction has not been applied to the BRIC.</i>

## Insurance Guidance for PFI Projects

Abbreviation	Meaning
<b>ICD</b>	Insurance Cost Differential
<b>IRP<sub>n</sub></b>	The nth Insurance Review Period. <i>It is helpful to use these terms when identifying each Insurance Project Review Period. i.e. the first IRP may have been 2000-2002, and therefore IRP2 would be 2002-2004 and so on.</i>
<b>JICR<sub>n</sub></b>	The Joint Insurance Cost Report relating to IRP <sub>n</sub> . <i>As above, to identify the first of the two years in each IRP it may be helpful to use the term JICR1, which will relate to the first IRP and JICR2, etc. for subsequent reports.</i>
<b>PA</b>	Project Agreement
<b>PIC</b>	Project Insurance Change
<b>PCS</b>	Portfolio Cost Savings (see Section 5 below)
<b>Period 1</b>	With respect to an IRP, the first annual period of that IRP <sup>17</sup> . <i>Because each IRP covers a two-year period, it is helpful to refer to each year within that period (because the insurances are usually annual policies). So, Period 1 within, for example, IRP3 covering 2005-6, would be the calendar year 2005 (or if the insurance renewal date is not 1st January each year, then whatever the first 12-month period is) and Period 2 within that IRP3 would be the 2006 calendar year or the second 12-month period).</i>
<b>Period 2</b>	With respect to an IRP, the second annual period of that IRP (see above).
<b>RIM</b>	Relevant Insurance Market

<sup>17</sup> **Guidance note 2.1:** *In this example there is a renewal date on the anniversary of the commencement of each Insurance Review Period.*

**Key data**

<b>Metric</b>	<b>Data</b>	<b>Explanation</b>	<b>Source</b>
Bid Date	7/11/2007	Used to determine the Bid Date RPI (below).	PA definitions
Base Cost (per annum)	£153,672	Used to determine BRIC: BRIC is the Base Cost indexed.	PA definitions
Bid Date RPI	201.6	Used to index the Base Cost in calculating BRIC.	ONS Published Index
RPI index	RPI <sup>x18</sup>	Used to index the Base Cost in calculating BRIC.	PA definitions
Relevant Insurance Inception Date	31/10/2010	Used to determine the beginning of each Insurance Review Period (see definition of Insurance Review Period).	JICR1
Period 1	31/10/2020–30/10/2021	Used to index the Base Cost in calculating BRIC.	N/A
Period 2	31/10/2021–30/10/2022	Used to index the Base Cost in calculating BRIC.	N/A

<sup>18</sup> **Guidance note 2.2:** This should reflect the definition of RPI in the Project Agreement.

## Insurance Guidance for PFI Projects

Metric	Data	Explanation	Source
RPI for <sup>19</sup> Period 1	295.5	Used to index the Base Cost in calculating BRIC.	ONS Published Index
RPI for Period 2	310.2	Used to index the Base Cost in calculating BRIC.	ONS Published Index
Market Movement Data (including any Relevant Insurance Market index if used) <sup>20</sup>	[XYZ index]	Used for the calculation in Schedule 2.	XYZ index

<sup>19</sup> **Guidance note 2.3:** *i.e. the RPI index value at the beginning of the relevant Period, as required by the definition of BRIC.*

<sup>20</sup> **Guidance note 2.4:** *The broker must refer to Market Movement Data in Section 8 and in their other calculations. Market Movement Data may or may not include reference to a market index (if any).*



# Section 3

## Relevant extracts of Project Agreement

**Guidance note 3.1:** *To assist the reader, it may be useful to set out here relevant extracts from the Project Agreement, including relevant definitions.*



# Section 4

## Calculations of BRIC and ARIC

### a. BRIC

Base Cost	£153,672
Bid Date RPI	201.6
RPI for Period 1	295.5
RPI for Period 2	310.2
RPI indexation factor for Period 1	$295.5 \div 201.6 = 1.466$
RPI indexation factor for Period 2	$310.2 \div 201.6 = 1.539$
Component of BRIC for Period 1 = Base Cost x RPI indexation factor for Period 1 = £225,283	
Component of BRIC for Period 2 = Base Cost x RPI indexation factor for Period 2 = £236,501	
<b>'Gross' BRIC</b> (i.e. prior to any BRIR) = £222,194 + £225,252 =	<b>£461,784</b>
<b>BRIR</b>	<b>£ 0</b>
<b>'Net' BRIC</b> (i.e. BRIC)	<b>£461,784</b>

**Guidance note 4.1:** In line with the definition of BRIC, RPI for Period 1 and Period 2 are the monthly RPI values the closest in time to the first day of the relevant Period and which are available at the date of the JICR.

**Guidance note 4.2:** The Base Relevant Insurance Reduction (BRIR) is a reduction to the BRIC that can be applied in cases of uninsurability where there has been a corresponding reduction in the unitary charge. The relevant definition can be found in SoPC. BRIRs are rare, so in most cases this figure will be nil.

## Insurance Guidance for PFI Projects

### b. ARIC

Period 1	
Material damage	£20,000
Business interruption	£15,000
Liabilities	<b>£6,000</b>
Total	£41,000
Period 2	
Material damage	£20,000
Business interruption	£17,000
Liabilities	<b>£7,000</b>
Total	£44,000
<b>ARIC</b>	<b>£41,000 + £44,000 = £85,000</b>

See Guidance Notes 4.3 and 4.4 below.

**Guidance note 4.3:** The figures for the cost of premiums should be taken from the separate Insurance Summary Sheet in Schedule 1

**Guidance note 4.4:** The ARIC should be based on the Relevant Insurance (such as Business Interruption relating to Unavoidable Fixed Costs) and not the Required Insurance as Relevant Insurances do not include all the Required Insurances. See 25.2.3 in SOPC4. However, Unavoidable Fixed Cost adjustments are nil or insignificant in the majority of cases. Where adjustments are required, the broker should demonstrate how it has calculated them.

We confirm that:

- the figures above relate exclusively to Relevant Insurances (and as such, in respect of business interruption, the premium has been adjusted to exclude any Unavoidable Fixed Costs);
- the figures above exclude all brokers' fees and commissions and insurance premium tax.

# Section 5

## Portfolio Cost Saving

**Guidance note 5.1:** SoPC requires the JICR to set out “full details of any Portfolio Cost Saving”.

Any savings arising during the relevant Insurance Review Period as a result of the project being moved into, or continuing to be included in, a portfolio should be counted. The quantum of the saving arising from the decision to include in a portfolio is a matter of fact and evidence in each case.

It is recognised that there are a number of reasons why it may be difficult to quantify Portfolio Cost Savings with accuracy in any given case where the project is in a portfolio. The broker should provide their best estimate, their supporting reasoning and the degree of assurance that the broker considers to be justified.

In this particular example, the project has been in the same portfolio since Period 1 of IRP1. The broker has some data on the quantum of the resulting savings at that time but none since then. Because they have no other evidence available to help determine the effect of Portfolio Cost Savings on ARIC in this Insurance Review Period, the approach the broker has taken in this example is to assume that amount of Portfolio Cost Savings will have roughly tracked RIM index from one IRP to the next since Period 1 of IRP1.

If there have been several movements of the insurance in and out of portfolios, the figures showing the savings may not all be available but an attempt must be made to estimate the savings. Similarly, not all the information from previous JICRs may be available so again the JICR should cover what it can.

Analysis of the project history shows that the insurances were moved into portfolios at the beginning of IRP1, and have remained in the same portfolios since then.

Information from JICR1 in relation to Period 1 of IRP1	
ARIC	£63,000
PIC factors	£0
Portfolio Cost Savings	£57,000
(Without PCS the ARIC for Period 1 of IRP1 would have been £63,000 + £57,000 = £120,000)	

## Insurance Guidance for PFI Projects

Market Movement Data for Period 1 of IRP6 (i.e. RIM index movement between Period 1 of IRP1 and Period 1 of IRP6): 0.65 (reduction of 35%) – see Schedule 2.

Market Movement Data for Period 2 of IRP6 (i.e. RIM index movement between IRP1 Period 1 and Period 2 of IRP6): 0.7 (reduction of 30%) – see Schedule 2.

Estimated Portfolio Cost Savings for Period 1 (of IRP6):  $0.65 \times £57,000 = £37,000$

Estimated Portfolio Cost Savings for Period 2 (of IRP6):  $0.7 \times £57,000 = £40,000$

Estimated Portfolio Cost Savings for IRP6 = £77,000.

**Guidance note 5.2:** *Although there is a requirement in SoPC to set out “full details of any Portfolio Cost Saving”, the result only affects the ICD calculation if there is an identifiable and quantifiable PIC (see section Part 2 paragraphs 32-35 of this Guidance Note). However in most cases the PCS calculation is for information only as PIC will be zero. It is best practice to give as much information as possible in the JICR within reason even if not all elements of this template are necessary as this will help build up a picture of the project over time and will make future JICRs easier to write and easier to review.*

# Section 6

## Project Insurance Changes (PIC) (if any)

**Guidance note 6.1:** *SoPC requires the JICR to set out “an assessment and quantification of each Project Insurance Change together with the reasons therefor”.*

### Limb (a) – Claims History or Re-Rating

**Guidance note 6.2:** *Has the claims history of the project had an adverse or beneficial impact on the ARIC? If so, how much of an impact on the ARIC in this Insurance Review Period? An adverse claims history may be easier to quantify as the history of the ARIC will show any obvious increases due to poor claims. A beneficial impact is far more nebulous as the initial rating that insurers apply to a risk will have been calculated with a nil claim experience from day one. In order to calculate a beneficial claims impact it would be necessary to get an underwriter to confirm a “No Claim Discount” that had been applied to the ARIC, which typically do not exist in the Relevant Insurance Market.*

The Contractor’s claims history is good. We do not consider that the Contractor’s claims history has impacted upon the variance between ARIC and BRIC in this Insurance Review Period.

Limb (a) Claims history impact on ARIC	£Nil
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## Insurance Guidance for PFI Projects

### Limb (b) – Deductible impact

**Guidance note 6.3:** *If the deductible has not changed since the level assumed at the start of the project, then this should be set as nil. If the deductible during the relevant Insurance Review Period is different from what was assumed, then the impact on the ARIC needs to be taken into account, except where the deductible exceeds the maximum permitted in the insurance schedule as a result of market conditions such that the regime for unavailability of a term or condition has been triggered.<sup>21</sup> If there is an issue with the deductible level then this should be fully explained in Section 8 (Broker's Opinion).*

There have been no changes to deductibles since the start of the project.

Limb (b) – Change in deductible impact on ARIC	<b>£Nil</b>
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### Limb (c) – Any other issue or factor (other than circumstances prevailing in the market and Portfolio Cost Savings)

**Guidance note 6.4:** *This category is relatively rare. Examples of limb (c) PICs are changes in the way that the Contractor runs the project that do not constitute a Variation.<sup>22</sup> See also the comments in the main body of this guidance in relation to good and poor risk management practices. Keep in mind that there has to be an impact on the ARIC for it to be quantified.*

We did not identify any other factors which would constitute a Project Insurance Change.

Limb (c) – Any other factor	<b>£Nil</b>
<b>Total value of limb (a), (b) and (c) PICs</b>	<b>£Nil</b>

<sup>21</sup> See SoPC4 footnote 45 if SoPC4 Unavailability provisions are contained in the Project Agreement.

<sup>22</sup> If they constitute a Variation then the Base Cost will have been recalibrated if necessary so as to maintain a constant risk profile, therefore there will be no PIC.

# Section 7

## Opinion of the Contractor on the factors that have increased or decreased ARIC relative to BRIC

**Guidance note 7.1:** *SoPC standard drafting requires each JICR to state any (other) reasons that the Contractor believes may have caused a change in the ARIC relative to the BRIC. What is being sought here is the Contractor's view on the factors that have affected the value of ARIC in the Insurance Review Period.*

*The broker should therefore seek the views of the Contractor and record them here. The broker's own opinion on the relevant factors should be included in the next section, including reference back to the Contractor's views and an explanation of whether the broker agrees or disagrees with the Contractor.*

*Experience has shown that typically Contractors can be reluctant to express an opinion on insurance matters, but this is not to say that they cannot. Any information and views expressed will help all stakeholders build up a picture of the project's insurance history for future reference so stakeholders should use reasonable endeavours to analyse any variance, even if not all historic data regarding insurance pricing, movement in and out of portfolios, changes to the project etc are available.*



# Section 8

## Opinion of the broker on the variance of ARIC from BRIC

**Guidance note 8.1:** SoPC requires the broker to set out their opinion as to the reasons why the ARIC has varied from the BRIC, specifying the impact of each of the factors and quantifying the amount attributable to each. This work will help to corroborate, support and sense-check any saving or extra cost calculated to be shared. Again, brokers may not have access to the historic data in order to complete all of these steps but reasonable endeavours must be used to try to explain what has happened to the project's insurances.

In this section the broker should seek to identify both:

- the factors that have increased or decreased ARIC relative to BRIC (i.e. the factors that have affected ARIC) in the relevant Insurance Review Period, including any identified by the Contractor in Section 7 (in this example, set out in Part A below); and
- the factors responsible for the difference between ARIC and BRIC (in this example, set out in Part B below).

### A. Factors causing increase/decrease in ARIC in this Insurance Review Period

- Portfolio Cost Savings:
- Market movement:
- PICs:
- Other factors:

**B. Analysis of the difference between ARIC and BRIC (using as much data as is reasonably available)**

Factors responsible for the initial ARIC (i.e. ARIC for Period 1 of IRP1) (source: JICR1, if available) See Section 2 for definitions.	<p><b>a.</b> Gross ARIC: £120,000</p> <p><b>b.</b> Portfolio Cost Savings: £57,000</p> <p><b>c.</b> PIC factors: <u>zero</u></p> <p>Initial ARIC: £63,000</p>
Factors responsible for the initial BRIC (i.e. BRIC for IRP1)(source: JICR1)	<p><b>a.</b> Base Cost p.a.: £153,672</p> <p><b>b.</b> Indexed (indexed up to Period 1 of IRP1) Base Cost: £180,961</p>
Factors responsible for the current BRIC (i.e. BRIC for IRP6)(source: Section 4)	<p><b>a.</b> Base Cost p.a.: £153,672</p> <p><b>b.</b> Indexed Base Cost (Period 1): £225,283</p> <p><b>c.</b> Indexed Base Cost (Period 2): <u>£236,501</u></p> <p>Total: £461,784</p>
Current ARIC (i.e. for IRP6) (source: Section 4)	<p><b>a.</b> £41,000 (Period 1)</p> <p><b>b.</b> £44,000 (Period 2)</p> <p>Total: £85,000</p>
Portfolio Cost Savings for IRP6 (source: Section 5)	<p><b>a.</b> £37,000 (Period 1)</p> <p><b>b.</b> £40,000 (Period 2)</p> <p>Total: £77,000</p>
PIC factors for IRP6 (source: Section 6)	<b>a.</b> Zero

The difference between ARIC and BRIC is **£376,784** as calculated above. It can be seen as the product of (i) the factors responsible for the initial values of ARIC and BRIC (i.e. for Period 1 of IRP1) and (ii) changes in those factors since that time.

## Insurance Guidance for PFI Projects

### Factors responsible for the initial values of ARIC and BRIC

The factors responsible for the initial value of BRIC are the Base Cost bid by the Contractor and RPI indexation between the Bid Date and Period 1 of IRP1.

We assume that the factors responsible for the initial value of ARIC are market movement and Portfolio Cost Savings, given that we are not aware of any other factors that may have influenced the initial value of ARIC.

### Changes in those factors since Period 1 of IRP1

The changes in the factors responsible for BRIC since Period 1 of IRP1 consist of RPI indexation between Period 1 of IRP1 and Periods 1 and 2 of IRP6 (i.e. in this case, the current IRP).

The changes in the factors responsible for ARIC since Period 1 of IRP1 are changes in market movement and changes in Portfolio Cost Savings. The change in Portfolio Cost Savings is considered in Section 5.

### Reconciliation

The initial ARIC/BRIC differential (i.e. for Period 1 of IRP1) is £117,961, which for a 2-year period equates to £235,922. Between Period 1 of IRP1 and IRP6 this has increased by £140,862 (£376,784 - £235,922).

Factors increasing the difference:

Changes in BRIC due to indexation (increasing BRIC): £99,862

Market movement (reducing ARIC): £78,000 (see Schedule 2)

Total: £177,682

Factors reducing the difference:

Reduction in Portfolio Cost Savings (increasing ARIC): £37,000

Total (net) change in factors = (+) £177,682 - £37,000 = (+) £140,862.

£235,922 (initial ARIC/BRIC differential)  
+ £140,862 (total change in relevant factors) = £376,784.

**The calculations in this Section 8 are for information, opinion and clarity purposes only as they do not affect the ICD calculation which is, essentially, ARIC - BRIC - (+/- PIC) = ICD.**

## Insurance Guidance for PFI Projects

**Guidance note 8.2:** *The reconciliation above results in an exact match, i.e. £376,784. It is appreciated that in reality an exact match will not be possible, given that some of the factors (for example, Portfolio Cost Savings) will be estimates. Nonetheless, the closer the reconciliation result, the more confidence it will give in the robustness of the broker's opinion.*

*The broker's analysis in Part (A) above is based on the reasoning that the value of ARIC itself is generally the most reliable evidence of the effect of market conditions, once any Portfolio Cost Savings have been accounted for.*

*It is possible to apply an alternative methodology that uses Market Movement Data (RIM index movements) to predict ARIC, as set out in Box 1 below. This will provide a corroborative sense-check on the other outputs of the JICR (such as the value of Portfolio Cost Savings) and may help explain why, if at all, this project appears to vary from the relevant insurance market movement. Explanations might include the effect of inflation on sums insured over the history of the project, use of particular build materials, adoption of new standards or regulations, variations etc. but it does not mean that the way the market "prices" such developments can constitute a PIC.*

*Box 1 uses the concept of Gross ARIC. See the explanation of the term and others in Section 2 above.*

*It is appreciated that this double-checking may be difficult to do if not all information is available but it is best practice to use reasonable endeavours to show as much evidence as possible at least for the first time on each project as it is then expected future JICRs will then involve much less work as a detailed history of the project is built up.*

### Box 1

*Gross ARIC for Period 1 of IRP1 x applicable market movement factor for Period 1 of IRP6 (see Schedule 2) = £120,000 x 0.65 = £78,000*

*Gross ARIC for Period 1 of IRP1 x applicable market movement factor for Period 2 of IRP6 (see Schedule 2) = £120,000 x 0.7 = £84,000*

*Total predicted Gross ARIC for IRP6 using this method = £78,000 + £84,000 = £162,000*

*Predicted ARIC for IRP6 using this method = Gross ARIC minus Portfolio Cost Savings = £162,000 - £77,000 = £85,000*

*If corroborative sense checks reveal significant inconsistencies, the broker should endeavour to provide additional supporting detail.*

# Section 9 Calculation of the Insurance Cost Differential and Exceptional Cost/Saving and the parties' respective shares

## a. Insurance Cost Increase/Decrease

The starting point is to calculate the Insurance Cost Differential (ICD).

The Insurance Cost Differential is: (ARIC - BRIC) - (± PIC)

**Guidance note 9.1:** *In this case there has been a cost decrease so a saving may follow but remember in some circumstances a cost increase may have occurred and an additional cost may be shared between the parties.*

This translates to:

$$(\text{£}85,000 - \text{£}461,784) - 0 = - \text{£}376,784$$

If the ICD is less than 1, it is an Insurance Cost Decrease. The value of the Insurance Cost Decrease is the ICD multiplied by -1:

$$-\text{£}376,784 \times -1 = \text{£}376,784$$

**Insurance Cost Decrease is £376,784**

## b. Exceptional Cost/Saving

**Guidance note 9.2:** *In circumstances where there is an Insurance Cost Decrease, there is the potential for an Exceptional Saving. Exceptional Saving is the amount by which an Insurance Cost Decrease exceeds 30% of the Base Relevant Insurance Cost for the relevant Insurance Review Period. So, to calculate the Exceptional Saving, the JICR should take the Insurance Cost Differential and deduct 30% of the BRIC.*

$$30\% \text{ of the BRIC} = \text{£}461,784 \times 30\% = \text{£}138,585$$

$$\text{Exceptional Saving} = \text{£}376,784 - \text{£}138,585 = \text{£}238,199$$

**Guidance note 9.3:** *If there is an Insurance Cost Increase, then there will be an Exceptional Cost if it is more than 30% of the BRIC and this cost will then be shared with the Authority.*

The Exceptional Saving is £238,199

## c. Sharing of Exceptional Cost/Saving

Exceptional Saving	£238,199
<b>Contractor's share 15%</b>	<b>£35,730</b>
<b>Authority's share 85%</b>	<b>£202,469</b>

The provisions for payment of the share are also set out in Section 3 and in this case the Contractor should pay the Authority its share by **20th December 2021**.

# Schedule 1 – Insurance Summary Sheet

**Guidance note S1:** An Insurance Summary Sheet is required by clause 2.2.3 of the SoPC model provisions to be submitted as part of the JICR. HM Treasury issued a simple template to complete but more complicated projects, e.g. where insurance policy renewal dates do not align with the Insurance Review Periods (IRPs), must have a more appropriately comprehensive spreadsheet. In either case, they must be submitted as downloadable spreadsheets and show a clear breakdown of premium rates and the sums insured for each of the Material Damage and Business Interruption covers, at the very least.

It must set out:

- the sums insured/limit of indemnity (i.e. rateable factor) for each of the Relevant Insurances;
- the premium rate for each of the Relevant Insurances;
- the net premium paid (or to be paid) for each of the Relevant Insurances (i.e. excluding both insurance premium tax and brokers' fees and commissions);
- details of any claims (paid or received) (including incident, date, type and quantum) in excess of [•] being the amount stated in Clause [•] of the Project Agreement. If there are no claims the broker should make a declaration to that effect rather than remaining silent.

Where the Contractor has purchased business interruption cover that includes losses other than Unavoidable Fixed Costs, details of how the cost of premiums has been apportioned between cover in respect of Unavoidable Fixed Costs and cover in respect of other losses should be provided.

In addition to any hard copy, the spreadsheet is to be provided in Microsoft Excel format

# Schedule 2 – Details of relevant Market Movement Data (or, if applicable, any Relevant Insurance Market index used)

**Guidance note S2:** The broker should set out here how any Market Movement Data (including, if applicable, indexation factors representing movements in a RIM index) which has been used to support the position/evaluation they have calculated.

In this example the broker has only used RIM index movements (and indexation factors) in Section 5 of this report but note that it may be that other Market Movement Data is more appropriate to use.

<b>Applicable (indexation factor) for Period 1 of IRP6</b>	
RIM index value at the beginning of IRP1:	100 (A)
RIM index value at the beginning of Period 1 of IRP6:	65 (B)
Indexation factor for Period 1 of IRP6:	$B/A = 0.65$
<b>Applicable (indexation factor) for Period 2 of IRP6</b>	
RIM index value at the beginning of IRP1:	100 (A)
RIM index value at the beginning of Period 2 of IRP6:	70 (B)
Indexation factor for Period 2 of IRP6:	$B/A = 0.7$

**Guidance note S3:** For simplicity, the calculation in Box 1 of the guidance note in Part B of Section 8 uses the data from JICR1 and the same indexation factors (representing index movement since Period 1 of IRP1) to predict ARIC in IRP6. However, if the broker feels comfortable with the last JICR (in this case JICR5) - which should normally be the case - then they could also base their projection of ARIC in IRP6 on the data from JICR5 and indexation factors representing index movement since IRP5.

**Guidance note S4:** The broker should put forward the best evidence available to support their position on each of the inputs that affect the sharing calculation. This is likely to vary from one input to another.

## Appendix 2 – Worked examples of a PIC being claimed

**This appendix illustrates how the sharing calculation (i.e. the calculation required by the definition of Insurance Cost Differential (“ICD”)) responds to PIC factors which increase (examples 1 and 2) or decrease (examples 3 and 4) ARIC in contexts where ARIC exceeds BRIC (examples 1 and 3) and where BRIC exceeds ARIC (examples 2 and 4). It is important to note that a PIC can be positive or negative as is explained in SoPC4 Chapter 25. 8 footnote 41.**

Example 1: PIC factor that increases ARIC; excess costs context (i.e. where  $ARIC > BRIC$ )

Assume  $ARIC = 10$ ,  $BRIC = 5$

$ARIC - BRIC = 5$

Assume the PIC factor (e.g. poor claims management) increased ARIC by 2. Applying the final paragraph of the ICD definition, the resulting PIC is given a positive value, because it increased ARIC.

$ICD = 5 - (+ 2) = 3$ .

By reducing the ICD the amount of excess costs entering the sharing calculation is reduced by 2, which proportionately increases the burden on the Contractor under the sharing mechanism.



### **Example 2: PIC factor that increases ARIC; cost savings context (i.e. where ARIC < BRIC)**

Assume ARIC = 5, BRIC = 10

$$\text{ARIC} - \text{BRIC} = -5$$

Assume the PIC factor increased ARIC by 2. Applying the final paragraph of the ICD definition, the resulting PIC is given a positive value, because it increased ARIC.

$$\text{ICD} = -5 - (+2) = -7.$$

By increasing the ICD, the amount of savings entering the sharing calculation is increased by 2, which proportionately reduces the benefit for the Contractor under the sharing mechanism.

### **Example 3: PIC factor that reduces ARIC; excess costs context (i.e. where ARIC > BRIC)**

Assume ARIC = 10, BRIC = 5

$$\text{ARIC} - \text{BRIC} = 5$$

Assume the PIC factor (e.g. increased deductibles) reduced ARIC by 2. Applying the final paragraph of the definition, the resulting PIC is given a negative value, because it reduced ARIC.

$$\text{ICD} = 5 - (-2) = 7$$

By increasing the ICD, the amount of excess costs entering the sharing calculation is increased by 2, which proportionately reduces the burden on the Contractor under the sharing calculation.

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### Example 4: PIC factor that reduces ARIC; cost savings context (i.e. where $ARIC < BRIC$ )

Assume  $ARIC = 5$ ,  $BRIC = 10$

$$ARIC - BRIC = -5$$

Assume the PIC factor reduced ARIC by 2. Applying the final paragraph of the definition, the resulting PIC is given a negative value, because it reduced ARIC.

$$ICD = -5 - (-2) = -3$$

By reducing the ICD, the amount of savings entering the sharing calculation is reduced by 2, which proportionately increases the benefit for the Contractor under the sharing calculation.