

Schedule 23

Insurance Premium Risk Sharing

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1 Definitions

1.1 For the purposes of this Schedule, the following words and expressions shall bear the following meanings:

Actual Relevant Insurance Cost means the aggregate of the [annual]¹ insurance premiums reasonably incurred by the Contractor to maintain the Relevant Insurance during the Insurance Review Period but excluding insurance premium tax and all broker's fees and commissions;

Base Cost means £[] being the amount as agreed at the Bid Date² and set out in the Financial Model which represents the insurance costs (which excludes amounts in respect of insurance premium tax and all brokers' fees and commissions) which are proposed to be incurred to maintain the Relevant Insurance in each year following the Services Availability Date, expressed in real terms as at the Bid Date;

Base Relevant Insurance Cost means, the aggregate of the Base Costs which were (at Bid Date) projected to be incurred to maintain the Relevant Insurance during the Insurance Review Period indexed by actual RPI from the Bid Date up to the dates on which the Relevant Insurance was placed or renewed either immediately before or during the Insurance Review Period (as applicable in respect of the year in question) less any Base Relevant Insurance Reduction;

Base Relevant Insurance Reduction the reduction to be made to the Base Relevant Insurance Cost in respect of a risk which has become Uninsurable or a term or condition which is no longer available and shall be an amount that is either:

- (a) the amount by which the Base Relevant Insurance Cost would have been a lesser amount had such a risk been Uninsurable or such a term or condition been unavailable at the Bid Date (which amount, for the avoidance of doubt, can be £0); or
- (b) if it is impossible to determine an amount pursuant to paragraph (a) above, an amount that is reasonable to be deducted from the Base Relevant Insurance Cost having due regard to:

¹ This will depend on the frequency of payment of insurance premiums.

² The Bid Date is the date on which the Contractor has fixed its price to appointment as Preferred Bidder. The Base Cost in bidders' models should be set at a long run median level such that the probabilities of the outturn costs being higher or lower in the future (after adjusting for RPI inflation) are the same. This is to ensure that the approach is consistent with the symmetrical sharing of Insurance Cost Differentials (ie +/-30% thresholds etc.). Furthermore, the median level should be held constant in real terms (year on year) and not profiled, as this will help to ensure that the symmetrical cost sharing band works as intended. Authorities and their advisers must take care to avoid accepting artificially depressed Base Cost figures which will underestimate the outturn unitary charge payment profile and simply lead to the Authority paying compensation above the upper 30% threshold during the Contract term. Conversely, they should not rely on the sharing of future cost reductions, below the lower 30% threshold as justification for an overestimated Base Cost still representing value for money.

- (i) the amount by which the Actual Relevant Insurance Cost is less than it would have been as a result of the risk becoming Uninsurable, or the term or condition becoming unavailable (the **Actual Reduction**);
- (ii) the size of the Actual Reduction as a percentage of the Actual Relevant Insurance Cost immediately prior to the risk becoming Uninsurable, or the term or condition becoming available; and
- (iii) the effects of RPI since the Bid Date;

Business Interruption Cover shall bear the meaning ascribed to it in Schedule 14 (Insurances³);

Construction Period Insurance means the Required Insurance in respect of the period from the date of this Agreement to the Service Commencement Date;

Contract Period means the period from and including the date of this Agreement to the Expiry Date, or if earlier, the Termination Date;

Contractor Related Party means the Contractor's agents and contractors (including without limitation the Sub-Contractors [and the Care Provider] and its subcontractors and its or their directors, officers, employees and workmen in relation to the Project and any person on or at any of the [sites] at the express or implied invitation of the Contractor (other than the Authority or any [Authority Related Party])⁴;

Exceptional Cost means, for an Insurance Review Period, the extent to which there is an Insurance Cost Increase which exceeds in amount 30% of the Base Relevant Insurance Cost for that Insurance Review Period;

Exceptional Saving means, for an Insurance Review Period, the extent to which there is an Insurance Cost Decrease which exceeds in amount 30% of the Base Relevant Insurance Cost for that Insurance Review Period;

First Insurance Review Date means the first Business Day following the first anniversary of the Relevant Insurance Inception Date;⁵

Insurance Cost Decrease means the Insurance Cost Differential if the value thereof is less than zero, multiplied by minus one;⁶

³ See Schedule 14 (Insurances).

⁴ This definition may need to be tailored on a project specific basis, depending on the sector in which the project is, let, e.g. schools projects should use the definition in the most recent version of the Schools standard form.

⁵ The first insurance review takes place 12 months and one day following the Relevant Insurance Inception Date. The costs considered at the time of the first review will be:

- the insurance premium payable to cover the first year of operation; and
- the insurance premium payable to cover the second year of operation.

With the exception of the last review, which, depending on Contract Period, may also occur after a shorter period, all other reviews will take place biennially.

Insurance Cost Differential shall, subject to the Insurance Review Procedure, be determined as follows:

Insurance Cost Differential = (ARIC – BRIC) – (+PIC)⁷
where:

ARIC is the Actual Relevant Insurance Cost

BRIC is the Base Relevant Insurance Cost

PIC is the Project Insurance Change

Insurance Cost Increase means the Insurance Cost Differential if the value thereof is greater than zero⁸

Insurance Cost Index means any index introduced by the United Kingdom Government or the Office of National Statistics after the date of this Agreement and which is anticipated to be published annually to provide an independent and objective measure of changes in prevailing market insurance costs;

Insurance Review Date means the First Insurance Review Date and, thereafter, each date falling on the second anniversary of the previous Insurance Review Date, except where such date lies beyond the end of the Contract Period, in which case the Insurance Review Date shall be the last renewal date of the Relevant Insurance prior to the end of the Contract Period;

Insurance Review Procedure means the procedure set out in paragraph 2 of this Schedule 23 (Insurance Review Procedure);

Insurance Review Period means a two year period from the Relevant Insurance Inception Date and each subsequent two year period commencing on the second anniversary of the Relevant Insurance Inception Date except where the end of such period lies beyond the end of the Contract Period, in which case the Insurance Review Period shall be the period from the end of the penultimate Insurance Review Period to the last day of the Contract Period;

Joint Insurance Cost Report shall bear the meaning ascribed to it in paragraph 2.2 of this Schedule 23 (Insurance Review Procedure);

PFI means the United Kingdom's Private Finance Initiative;

Portfolio Cost Saving means any insurance cost saving which arises from the Contractor changing the placement of the Required Insurances from being on a stand-alone project-specific basis assumed at Financial Close and reflected in the Base Cost, to being on the basis of a policy (or policies) also covering risks on other projects or other matters which are outside the scope of the Project so as

⁶ The Insurance Cost Decrease is always a positive sum (if not zero).

⁷ In accordance with the definition of Project Insurance Change, the PIC may have either a positive or a negative value. In the event that the PIC is positive then the PIC is subtracted from the difference of the ARIC and the BRIC. If the PIC is negative, then the double negative means that the value of the PIC (ignoring the negative sign) is added to the difference of the ARIC and the BRIC.

⁸ The Insurance Cost Increase is always a positive sum (if not zero).

to benefit from portfolio savings A Portfolio Cost Saving is defined to be a positive sum and cannot be less than zero⁹;

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
 - (ii) the deductible, further to such change, is either greater than or equal to the maximum¹⁰ in Schedule 14 (Insurances)¹¹;
- (c) any other issue or factor other than circumstances generally prevailing in the Relevant Insurance Market, except for any Portfolio Cost Saving¹²

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

Relevant Insurance means the Required Insurance and any other insurances as may be required by law other than:

- a) Construction Period Insurance¹³;
- b) Business Interruption Cover except to the extent that it relates to Unavoidable Fixed Costs¹⁴; and

⁹ An Authority may not be compelled to join a portfolio solution which places it in a worse position than if insurance is placed on a separate stand-alone basis.

¹⁰ The Authority, in conjunction with its advisers, should set the maximum deductibles in the Required Insurance Schedule (see Schedule 14 (Insurances)) at the highest acceptable level.

¹¹ The effect of this clause is to incentivise the Contractor to manage and optimise the trade-off between insurance premium and deductible levels for deductible levels below the maximum stipulated within the Authority Required Insurances, whilst providing protection in two specific circumstances: the first is where, due to circumstances generally prevailing in the Relevant Insurance Market, the cost of maintaining deductibles at the maximum stipulated in the Required Insurance Schedule has increased; and the second is where, due to circumstances generally prevailing in the Relevant Insurance Market, the Required Insurances can only be purchased with deductible levels above the maximum stipulated in the Schedule, wherein two principles apply: (a) the Contractor is given relief from breach by virtue of the provisions which deal with terms and conditions that become unavailable (clause 66.7 (Unavailability of Terms and Conditions) and (b) the additional cost of purchasing insurances even at these increased deductible levels is eligible as an Insurance Cost Differential.

¹² This means that in addition to portfolio cost savings, changes which are attributable to a general movement in insurance costs across the entire PFI market will be taken into account.

¹³ This is assumed to be covered under fixed-priced arrangements and so not subject to variation.

¹⁴ In addition to senior debt service costs, the Contractor may incur other unavoidable costs if the start of the operational period is delayed or in the event of an interruption to the operation of the project, eg. any fixed cost for the provision of utilities. These unavoidable costs will vary from project to project. Unavoidable Fixed Costs is defined in part 5 of Schedule 14 (Insurances) and excludes Distributions.

c) [any ancillary insurances]¹⁵;

Relevant Insurance Inception Date means the date on which the Relevant Insurance is first providing active insurance cover to the Contractor, being a date no earlier than the Service Commencement Date;

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

Required Insurance shall bear the meaning ascribed to it in the Agreement¹⁶; and

RPI [shall bear the meaning ascribed to it in the Agreement].

2 Insurance Review Procedure¹⁷

2.1 This procedure shall be used to determine whether the Authority shall bear any increase or benefit from any decrease in Relevant Insurance costs.

2.2 The Contractor's insurance broker shall prepare a report on behalf of both the Contractor and the Authority (the **Joint Insurance Cost Report**). The Report is to be prepared at the Contractor's expense, and should, as a minimum, contain the following information for the relevant Insurance Review Period:

2.2.1 A full breakdown of the Actual Relevant Insurance Cost;

2.2.2 A full breakdown of the Base Relevant Insurance Cost;

2.2.3 A spreadsheet (the **Insurance Summary Sheet**) detailing separately:

2.2.3.1 the sum(s) insured/limit of indemnity (ie rateable factor) for each of the Relevant Insurances;

2.2.3.2 the premium rate for each of the Relevant Insurances;

2.2.3.3 the net premium paid (or to be paid) for each of the Relevant Insurances (ie excluding both insurance premium tax and brokers fees and commissions);

2.2.3.4 the deductible(s) for each Relevant Insurance;

¹⁵ If the Required Insurance contains any supplementary (i.e. non-standard) insurances, for which Insurance Premium Risk Sharing is not being provided, these must also be referred to here.

¹⁶ This will comprise the insurances in the required insurance schedule contained in the Contract, which should be based on the Standard Required Insurance Schedule (See Schedule 14 (Insurances)).

¹⁷ The insurance review procedure takes place around each Insurance Review Date. The cost of insurance for the previous year and the cost of insurance for the current year are assessed at each review. With the exception of the first review, which takes place one day after the first insurance renewal, and possibly, depending on the Contract Period, the last review, all other reviews will take place biennially.

- 2.2.3.5** details of any claims (paid or reserved) (including incident date, type and quantum) in excess of £[]¹⁸, being the amount stated in clause 64.8 (Insurance);
- 2.2.4** An assessment and quantification of each Project Insurance Change together with the reasons therefore;
- 2.2.5** Full details of any Portfolio Cost Saving;
- 2.2.6** Any other reasons that 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 Cost;
- 2.2.7** The opinion of the Contractor's insurance broker as to the reasons why the Actual Relevant Insurance Cost has varied from the Base Relevant Insurance cost, specifying the impact of each of the factors and quantifying the amount attributable to each factor specified above;
- 2.2.8** The calculation of the Insurance Cost Differential and any Exceptional Cost or Exceptional Saving arising from this calculation; and
- 2.2.9** Evidence satisfactory to the Authority (acting reasonably) of any changes to circumstances generally prevailing in the Relevant Insurance Market that are claimed to account for the Insurance Cost Differential;
- 2.2.10** Details of movements in the CBS Private Capital non marine index¹⁹ plus, if available from other appropriate sources, details of changes in insurance cost across the PFI market as a whole²⁰.
- 2.3** The Contractor shall procure that the Broker, no later than the date which is ten (10) Business Days after the Insurance Review Date, delivers to the Authority, at the same time as it delivers to the Contractor, at least two copies of the Joint Insurance Cost Report. At the same time the Contractor should send a copy of the Insurance Summary Sheet to HM Treasury private finance unit or its nominee. Following receipt of the Joint Insurance Cost Report, the Authority shall notify the Contractor in writing within fifteen (15) Business Days whether or not it accepts the Joint Insurance Cost Report including full details of any disagreement.²¹ If the Authority does not provide such notification and/or details of any disagreement to the Contractor within fifteen (15) Business Days, the Authority shall be deemed to have accepted the Joint Insurance Cost Report. If

¹⁸ This amount should correspond to the amount agreed under clause 64.8 (Notification of Claims).

¹⁹ CBS Private Capital (CBSPC) is a Lloyd's members' agent, specialising in the provision of advisory and administrative services to private and corporate capital providers underwriting in the Lloyd's insurance market. CBSPC uses syndicated analysts to undertake market research and, as part of its activities, maintains an index of insurance cost changes across the main asset classes. The CBSPC Market Rate Index was the first index of its kind, specifically focusing on the Lloyd's insurance market. It was started in 1994 and tracks the rate movements in the four main Lloyd's markets. The index was re-launched in 2005 when it was rebased to 1997, enabling investors to gauge where they are in the insurance cycle. The CBSPC non marine index may be accessed via the following web address: <http://www.cbs-lloyds.co.uk/cgi-bin/mri/FileReader.pl>.

²⁰ A source for such data could be Partnerships UK or any other body nominated by HM Treasury to act as custodian of the insurance Summary Sheets.

²¹ The Authority should consider employing the services of a fully "independent" insurance advisor to confirm the accuracy of the information in the Joint Insurance Cost Report.

the Authority disagrees with any item in the Joint Insurance Cost Report, the Parties shall use their respective reasonable endeavours acting in good faith to agree the contents of the Joint Insurance Cost Report.²² If the Parties fail to agree the contents of the Joint Insurance Cost Report within thirty five (35) Business Days from the date it was delivered to the Authority, the matter shall be resolved pursuant to the Dispute Resolution Procedure, provided always that references in clause [27(d)] to an expert shall be construed as references to an independent insurance expert agreed by the Parties or, in the absence of agreement, appointed by the President for the time being of the Chartered Institute of Arbitrators.

- 2.4** The Authority may make the Joint Insurance Cost Report available to any of its or HM Treasury's agents or advisers or other body or bodies nominated by HM Treasury for insurance cost verification, benchmarking or similar purpose.

3 Sharing of Exceptional Cost and Exceptional Saving

- 3.1** If, following the completion of the Insurance Review Procedure, it is agreed or determined that there is an Exceptional Cost, the Authority shall within thirty (30) days of completion of the Insurance Review Procedure make a one-off lump-sum payment to the Contractor equal to 85% of the Exceptional Cost.

- 3.2** If following the completion of the Insurance Review Procedure, it is agreed or determined that there is an Exceptional Saving, the Contractor shall within (30) days of completion of the Insurance Review Procedure make a one-off lump-sum payment to the Authority equal to 85% of the Exceptional Saving.

- 3.3** Following the completion of the Insurance Review Procedure, if it is agreed or determined that there is neither an Exceptional Cost nor an Exceptional Saving, any Insurance cost Differential shall be borne by or benefit the Contractor.

4 Insurance Cost Index

If at any time an Insurance Cost Index is published and intended for use in PFI contracts of a similar nature to this Agreement, the parties shall meet with a view to agreeing:

- 4.1** its application to the Project, taking account any relevant guidance issued by HM Treasury; and
- 4.2** how a Portfolio Cost Saving may be accounted for when index is in use.

²² This may involve observing how insurance costs have changed during the same period across a representative sample of PFI projects from all of the PFI sectors. Such information is likely to be available from a number of sources. The collation of Insurance Summary Sheets centrally should facilitate this exercise.