



**Insurance Review: Consultation**  
**November 2006**



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## ***Executive summary***

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1. Most rail operators in Great Britain are required to maintain public liability insurance on terms approved by the Office of Rail Regulation (ORR).
2. We highlighted the need to review this area in our 2005 Licensing Review. Stakeholders agreed, and we included this work in our 2006/09 Business Plan. This document delivers that commitment.
3. We have approached this review with our duties under domestic and European licensing rules, the principles of better regulation and the need for more focused and effective intervention firmly in mind.
4. We propose to give operators wider discretion over their public liability insurance arrangements, by reducing the standard *minimum* level of cover required for each operator to £100m per incident. This reflects an improving safety environment and claims history. It also reflects directors' obligations to consider and manage risk, even above the minimum, where that is appropriate. All operators should benefit from reduced costs given this wider discretion, and the increased leverage it would give them when buying insurance. Some operators who must currently buy more insurance than they really need could make significant savings.
5. It will remain the responsibility of individual operators to make their own assessment of the most appropriate level of cover for their business. As now, some operators will choose to buy more cover (Network Rail, for example). As now, operators will be able to request a lower limit apply to them. Lower limits that have already been set for some operators will continue to apply.
6. We propose to refocus our monitoring and approval work in line with the principles of better regulation, where the risks are greatest. This means that operators would no longer have to submit details of their arrangements to ORR for detailed review every year.
7. Our proposals seek to strike the right balance across our various duties, and to reduce industry costs while incentivising proper risk management. We invite views on all the issues raised.



# 1. Introduction

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## Context

- 1.1 Most rail operators in Great Britain are required to maintain public liability insurance on terms approved by the Office of Rail Regulation (ORR). The obligation is imposed mainly through operator licences and related authorisations. We do not directly regulate any other type of insurance.

## Purpose

- 1.2 We highlighted the need to review our approach to these arrangements during our 2005 Licensing Review<sup>1</sup>. Stakeholders agreed, and we included this work in our 2006/09 Business Plan. This document delivers that commitment.
- 1.3 We have approached this review with our duties under domestic and European licensing rules, the principles of better regulation and the need for more focused and effective intervention firmly in mind<sup>2</sup>.
- 1.4 Our most relevant duties are to protect the interests of users of railway services, to promote competition, to impose on operators the minimum restrictions necessary, to promote efficiency and economy and to enable operators to plan their businesses.

## Structure

- 1.5 Chapter 2 sets out the current arrangements. We propose changes to our policy on insurance in Chapter 3. Chapter 4 sets out proposals to radically reduce the burden of the insurance approval process using a new 'general approval', and to refocus our monitoring work. A draft general approval is at Annex A. Annex B sets out a new, simpler licence condition for insurance. The consultation questions are listed at Annex C.

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<sup>1</sup> See <http://www.rail-reg.gov.uk/server/show/nav.199>.

<sup>2</sup> See the ORR Corporate Strategy and Business Plan at <http://www.rail-reg.gov.uk/server/show/ConWebDoc.6686>.

## Responses and timetable

- 1.6 We invite your comments on any aspects of our insurance arrangements, and in particular on the questions listed at Annex C. The consultation period runs for 8 weeks until **22 January 2007**. This period reflects the specialist topic, the positive responses in favour of change we received during the Licensing Review, our recent informal discussions with stakeholders, the deregulatory nature of the proposals, and the need to clarify arrangements for the March 2007 insurance renewals round.
- 1.7 We would prefer to receive consultation responses by email to [Gordon.Herbert@orr.gsi.gov.uk](mailto:Gordon.Herbert@orr.gsi.gov.uk). Alternatively, you may send your response by post to:
- Gordon Herbert  
Senior Executive  
Licensing Team  
Office of Rail Regulation  
One Kemble Street  
London WC2B 4AN
- 1.8 You should indicate clearly if you wish all or part of your response to remain confidential to ORR. Otherwise, we will make it available in our library, publish it on our website and we may quote from it. Where you make a response in confidence, you should attach a summary, excluding the confidential information, which can be treated as above. We may also publish the names of respondents in future documents or on our website, unless a respondent indicates that they wish their name to be withheld.
- 1.9 The issues we raise and the consultation process itself can be discussed with Gordon Herbert (020 7282 3964) or Julia Christie (020 7282 2149). This document can be accessed on our website<sup>3</sup> and through the ORR library.
- 1.10 Subject to responses, we hope to publish conclusions in February 2007 and to implement our conclusions as soon as possible thereafter. In the meantime, the current ORR policy and approval procedures for operator insurance arrangements remain in force.

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<sup>3</sup> See [www.rail-reg.gov.uk](http://www.rail-reg.gov.uk).



## 2. Background

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### Regulatory framework

- 2.1 Operators of trains, stations, light maintenance depots and networks in Great Britain must be appropriately authorised under the Railways Act 1993 (the Act) and The Railway (Licensing of Railway Undertakings) Regulations 2005 (the Regulations).
- 2.2 A criterion for holding a licence is that operators must make arrangements to cover their liabilities in the event of accident to third parties, including passengers. The Regulations give ORR the task of approving these arrangements as adequate. We do not directly regulate any other type of insurance cover.
- 2.3 We always include the obligation to have approved arrangements as a condition in licences granted under the Act, and in Statements of National Regulatory Provisions (SNRPs) granted under the Regulations.
- 2.4 Some mainline maintenance contractors who work for Network Rail in engineering possessions are authorised by a licence exemption. We always include the same obligation to have approved insurance arrangements in these licence exemptions.
- 2.5 We do not normally include the obligation in other licence exemptions, like those held by smaller heritage operators.
- 2.6 ORR inherited responsibility for these matters from the SRA on 24 July 2005. We have applied SRA's insurance policy and procedures to date.
- 2.7 A related obligation imposed on licence holders is to join the industry Claims Allocation and Handling Agreement (CAHA). CAHA shields the public from the complexity of the multi-operator railway when making claims. The agreement is reviewed periodically by the Railway Industry Dispute Resolution Committee. CAHA is not covered by this consultation.

## **ORR guidance**

- 2.8 The minimum requirements that must normally be met for ORR to approve insurance arrangements are set down in guidance. The current guidance can be downloaded from our website<sup>4</sup>.
- 2.9 In summary, at present each operator's arrangements must:
- (a) provide cover of at least £155m per incident;
  - (b) cover accompanied personal luggage and damage to the property of rail industry parties;
  - (c) include other parties who must be insured or indemnified in any underlying agreement with the operator, topping up any cover they hold as necessary to meet the guidance; and
  - (d) not exclude liability in relation to computer date change problems.
- 2.10 Operators may self-insure for all or part of their cover, including any policy deductible. We require director and auditor statements to support the chosen level of self-insurance.
- 2.11 ORR approves every element of every operator's arrangements by formal letter, whenever arrangements are set up or renewed. Insurance is normally purchased annually in layers. Each layer is considered and our professional insurance advisors scrutinise every policy.
- 2.12 Two more requirements are set out in the standard licence and SNRP condition wording: ORR must be notified on cancellation of or material change to an insurance policy, and operators must make changes to their arrangements when we reasonably request them to.

## **The insurance market**

- 2.13 The market for rail insurance has matured in the years since privatisation.
- 2.14 There have been periods where the market was concentrated and cover was available only through a very limited number of providers. This was the case

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<sup>4</sup> See <http://www.rail-reg.gov.uk/upload/pdf/249.pdf>.

with “primary” layer cover<sup>5</sup>, particularly as some insurers withdrew after the Ladbroke Grove and Hatfield incidents.

- 2.15 However, new insurers have entered the market since then. We have noted high levels of switching insurers by operators, and market concentration has fallen. GB rail insurance is one segment of a competitive international market and the barriers to entry and exit are low.
- 2.16 Operators are also developing more sophisticated approaches to insurance and risk management. For example, Network Rail and several Train Operating Companies (TOCs) now use captive insurance subsidiaries.
- 2.17 In 2004 Network Rail extended its cover to include its maintenance contractors, securing savings of up to £20m per year. Network Rail will also consider including other operators in its insurance programme. There have been other industry initiatives too.

## Premiums

- 2.18 There is currently limited information in the public domain about the cost of individual insurance policies.
- 2.19 A 2004 survey suggested insurance cost the industry £100-150m per year in total premiums, of which public liability insurance accounted for about half. Premiums vary widely. A small new entrant’s annual premium for public liability insurance might be £300-400k. Larger operators may pay well over £1m, up to £20m+ for the very largest.
- 2.20 Premiums increased sharply between 1999 and 2002. Premiums gradually decreased, in real terms, between 2003 and 2005. Overall the increase in prices since 1999 has been higher for rail than general UK liability insurance costs.
- 2.21 Premiums are affected by many factors including the type of operation, the individual and industry claims history and the state of the global insurance market. Issues unconnected to railways can have a significant impact, such as the severity of the hurricane season.

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<sup>5</sup> The first layer of insurance that can be called upon, covering the first £10-20m of claims.

- 2.22 Insurers' increasing knowledge of the rail industry, the good safety record since 2000 and increasing competition have all contributed to insurance premiums falling since the 2002/03 peak.
- 2.23 Under the Railways and Other Guided Transport Systems (Safety) Regulations 2006 (ROGS), operators must provide key safety data to the European Rail Agency (via ORR), starting in Summer 2007. This data includes the cost of claims made.
- 2.24 High quality claims data should promote efficient pricing of insurance, and could encourage further new entry by insurers. A European Rail Agency working group is considering how this will work and issues of confidentiality and data quality, with input from the Rail Safety & Standards Board<sup>6</sup>.

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<sup>6</sup> See [http://www.era.europa.eu/public/Safety/Monitoring\\_Safety\\_Performance.aspx](http://www.era.europa.eu/public/Safety/Monitoring_Safety_Performance.aspx).

## 3. Insurance requirements

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### Proposals

3.1 We propose:

- to leave the scope of the insurance cover required unchanged, save that we now delete a restriction relating to date change risk;
- to reduce the default *minimum* level of cover required to £100m per incident; it will remain the responsibility of operators to make their own assessment of the most appropriate level of cover for their business; and
- that the industry should continue to build strong relationships with insurers and to pursue cost saving initiatives.

### The scope of cover required

3.2 The scope of cover currently required seems broadly appropriate.

3.3 However, it is not clear that we still need to make explicit reference to computer date change problems. This provision related to the 'millennium bug' and we propose to delete it.

3.4 Our guidance is also silent on public liability cover for terrorist incidents. Some insurers exclude this liability, often reflecting their arrangements with their re-insurers. Employers' liability insurance cannot exclude terrorism related claims up to £5m. However, cover is increasingly available and some larger operators like Network Rail now have it. There are separate national arrangements covering property damage from terrorism, and a criminal injuries compensation scheme.

3.5 The costs, benefits and effects of extending our requirements in this area are unclear. Therefore, we do not propose to require terrorism liability cover.

### The minimum amount of cover required

#### *Variable levels of cover*

3.6 ORR could set an insurance requirement for each operator on a case-by-case basis. However, the GB mainline is essentially a mixed traffic network and

different operators can face similar hazards. Moreover, a case-by-case approach would not capture individual operator's different attitudes to risk and would be costly and complex to administer.

- 3.7 We therefore propose to retain the current simple approach where we set a single default minimum cover requirement for all operators.

*How much cover?*

- 3.8 We have considered whether the current minimum requirement of £155m per incident remains appropriate, taking advice from our insurance consultants Willis Ltd.

- 3.9 We propose to reduce the default minimum level of cover required to £100m per incident. It will remain the responsibility of individual operators to make their own assessment of the most appropriate level of cover for their business.

- 3.10 The main arguments for a lower minimum level of cover are:

- No GB rail incident has cost more than £65-70m in personal injury claims and such events are exceptionally rare. There were no major train incidents involving multiple passenger injuries or fatalities in 2005<sup>7</sup>.
- Improving track condition and safety initiatives like the introduction of the Train Protection Warning System have reduced the risk of serious accidents<sup>8</sup>. The industry is therefore over-insuring by buying cover for an increasingly unlikely type of event.
- Some safety initiatives have also reduced the potential severity of some types of accident. For example, the removal of older Mark 1 passenger rolling stock from the network.
- A lower minimum requirement will give operators wider discretion over their arrangements, and increased leverage when buying cover above the minimum level; and
- Company directors are already obliged to consider the risks they face and how best to manage them.

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<sup>7</sup> See our 2005 report on railway safety at <http://www.rail-reg.gov.uk/upload/pdf/296.pdf>.

<sup>8</sup> See [http://www.rssb.co.uk/pdf/reports/Risk\\_Profile\\_Bulletin\\_-\\_Overview\\_of\\_Issue\\_5.pdf](http://www.rssb.co.uk/pdf/reports/Risk_Profile_Bulletin_-_Overview_of_Issue_5.pdf).

- 3.11 Insurance costs can be disproportionately high for new entrants, up to a third of first year turnover in some cases<sup>9</sup>. New entrants may suffer from having no claims track record, and limited operations do not result in proportionately lower premiums.
- 3.12 We set the highest minimum insurance requirements in Europe by a considerable margin. Other Member States' minimum requirements are in the range £300k to £70m<sup>10</sup>.
- 3.13 However, comparisons are difficult given economic, legal and network differences. We will work with the other European licensing authorities to understand these differences.

#### *Liabilities under the access regime*

- 3.14 Operators will need to consider whether the new minimum insurance requirement is sufficient to ensure they will be able to meet their potential liabilities to Network Rail under track access contracts.
- 3.15 These liabilities are capped at £5m or £10m for freight train operators. Passenger train operator liabilities are capped in proportion to their variable track access charges, with a minimum of £10m. The highest limits are around £90-100m.
- 3.16 However, most operators' exposure under track access contracts is limited to less than £50m. These limits apply per year, whereas the insurance requirement is per incident. Public liability insurance policies do not normally cover lost profit and revenue, which are included in the liability regime. And there are mechanisms to fund Network Rail's business if a major creditor defaulted.

#### *Derogations*

- 3.17 Currently, operators may apply to us for a different minimum requirement to apply. We consider these requests on a case-by-case basis, taking advice from specialist insurance advisers. We ask operators to provide an

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<sup>9</sup> See *Insurance of Railway Undertakings*, European Commission DG TREN, September 2006, page 47. <http://ec.europa.eu/transport/rail/research/doc/railway-insurance.pdf>.

<sup>10</sup> Same reference as at footnote 9, page 21.

independent risk assessment to support their request. Derogations remain exceptional and are not normally appropriate for mainline operations.

- 3.18 We propose to retain the current flexible derogation arrangements. Existing derogations held by operators will remain valid.

#### *Operator duties*

- 3.19 ORR only sets a *minimum* level of cover. ORR policy does not in any way limit an operator's potential liability. It is for operators to consider their own actual requirements, given their knowledge of their business and attitude to risk.
- 3.20 Operators are free to buy higher levels of cover beyond the minimum specified by ORR, and in some cases it will be appropriate for them to do so. Network Rail is one of several operators that already choose to buy cover above the minimum required.

### **Industry insurance initiatives**

- 3.21 We welcome the savings made by Network Rail by extending its insurance cover to its maintenance contractors. We also welcome its willingness to consider including other operators in its insurance programme, where consistent with its wider network licence obligations. This is a useful additional option for other operators, when carefully structured to avoid reducing their own incentives to manage risk.
- 3.22 More widely, collective purchasing of insurance for operators could lead to savings. But the costs and benefits of such a scheme are unclear. Moreover, some operators would have concerns given their varying circumstances, approaches to risk and potential competition issues.
- 3.23 Therefore, we propose the industry should continue to build strong relationships with insurers and re-insurers, and to develop its own insurance initiatives. For example, there may be scope for operators to collectively purchase catastrophe level cover.

### **Impact**

- 3.24 Some operators like Network Rail already choose to buy more cover than the minimum required; their arrangements will not be affected. Similarly, lower requirements that have already been agreed for a few operators will continue



to apply. We do not know how operators currently buying the minimum level of insurance cover required will respond to a new, lower minimum. However, savings should result from operators' increased choice.

- 3.25 An operator that chose to buy cover up to the new lower level might expect to save 10-15% of their total public liability insurance premium. For smaller new entrants this could be worth up to £50k per year.

## Questions

- Q1 Do you agree the requirement not to exclude computer data change risks from public liability insurance policies can be deleted?
- Q2 Do you agree the scope of public liability cover required should otherwise be left unchanged, and that there is no need to specifically include terrorism?
- Q3 Do you agree the default *minimum* amount of public liability cover required should be reduced to £100m per incident?



## 4. Insurance approval process

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### Proposals

4.1 We propose:

- that operators will *not* routinely need to send details of their insurance arrangements to us for approval; and
- to refocus our monitoring and approval work on new entrants, with a rolling programme of risk-based auditing for other operators.

### General approval

4.2 We propose to withdraw our current (27-page) insurance guidance, and replace it with a (2-page) general approval (see Annex A) that would be referenced by the licence condition.

4.3 This would set out the key requirements operators' arrangements must meet, such as the minimum cover required per incident. It would also require operators to keep appropriate records setting out their arrangements, and to make these available to us on request.

4.4 But it would not be prescriptive about the form of those records, or require costly supporting auditor statements to be prepared.

4.5 Nor would it require operators to routinely submit details of their arrangements to ORR for explicit approval.

4.6 The general approval would set out our current right to reasonably require arrangements be changed. There would then be no need to replicate this right in the standard licence condition, which could then be shortened. The current licence condition and a new, simpler condition are at Annex B.

### Monitoring

4.7 In line with Hampton and better regulation principles<sup>11</sup>, we propose to target our resources primarily using a risk-based approach. This would involve a

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<sup>11</sup> See, for example, [http://www.hm-treasury.gov.uk/budget/budget\\_05/press\\_notices/bud\\_bud05\\_presshampton.cfm](http://www.hm-treasury.gov.uk/budget/budget_05/press_notices/bud_bud05_presshampton.cfm)

rolling programme of audits, focusing on a small number of operators each year.

## Impact

- 4.8 Stopping the routine submission and review of insurance documents will save operators considerable time, and the cost of specialist advice. The exact amount will vary between operators. It will also allow ORR to focus resources where they will be most effective.
- 4.9 There could be some risk that operators buy inappropriate or insufficient cover. We will manage this risk by continuing to review and approve new entrants' arrangements in detail, and by auditing a small sample of other operators each year.

## Questions

- Q4 Do you agree we should replace the current insurance guidance with a shorter general approval? Do you have any comments on the proposed general approval at Annex A?
- Q5 Do you have any comments on the simpler licence condition at annex B?
- Q6 Do you agree that operators should *not* routinely need to send details of their insurance arrangements to us for approval?
- Q7 Do you agree ORR should target its monitoring and approval work on new entrants, and a rolling programme of risk-based auditing?

# Annex A: Proposed general approval

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## General approval

1. This general approval applies to operators of railway assets who hold licences, licence exemptions or SNRPs with an obligation to establish and maintain certain insurance arrangements approved by ORR.
2. The obligation arises under Sections 7 and 8 of the Railways Act 1993, and Section 11 of the Railway (Licensing of Railway Undertakings) Regulations 2005 (the Regulations).
3. This general approval does **not** apply to new operators in their first year of operations. New operators need to submit their detailed arrangements to ORR for approval in the first instance. The requirements for these operators are set out in ORR's Licensing Guidance.
4. ORR approves the insurance arrangements of relevant operators to the extent that:
  - (a) Total cover of not less than £100m per incident is provided in respect of all liabilities to third parties;
  - (b) Cover is on an 'occurrence' basis;
  - (c) The operator shall include as an insured any other party to the extent that that party is required to be insured or indemnified in any underlying contract or agreement with the operator;
  - (d) The operator will provide cover for any difference between its contractors' or sub-contractors' cover and that required by this general approval;
  - (e) The operator has a reasonable expectation of meeting any excess or deductible that applies to its insurance policies;
  - (f) Insurance policies are taken out only with insurers duly authorised by the Financial Services Authority or an equivalent body; and
  - (g) Insurance arrangements will apply at all times operations are undertaken.
5. This general approval is subject to the conditions in paragraph 6.

6. The conditions are:
  - (a) The operator will maintain for a minimum of seven years appropriate records setting out its particular arrangements, the rationale for those arrangements and how the arrangements meet the terms of this general approval.
  - (b) The operator will submit these records to ORR for review upon request.
  - (c) The operator will modify the arrangements covered by this general approval if reasonably required to do so by ORR.
  - (d) ORR can withdraw approval from any operator at any time.
7. Failure to comply with the terms of this general approval could leave an operator liable to enforcement proceedings under Sections 55 to 57 of the Act and Regulation 8 of the Regulations.
8. For further information about this approval, please contact:

The Licensing Team  
Office of Rail Regulation  
One Kemble Street  
London WC2B 4AN

Tel: 020 7282 2068  
Fax: 020 7282 2043

Email: [licensing.enquiries@orr.gsi.gov.uk](mailto:licensing.enquiries@orr.gsi.gov.uk)

## Annex B: Proposed new licence condition

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### Current licence condition:

#### Insurance Against Third Party Liability

1. The licence holder shall, in respect of licensed activities, maintain insurance (including self-insurance) against third party liabilities on terms approved by ORR (including, but without limitation, with respect to the type, cover and level of insurance and identity of insurer), with any such modification as may be required pursuant to paragraph 3.

2. The licence holder shall, except where ORR may otherwise consent, ensure that every insurance policy maintained pursuant to paragraph 1 shall require 30 days' notice to be given to ORR by the insurer or insurance broker of any lapse or cancellation of or material change to the policy.

3. Where ORR notifies the licence holder that ORR reasonably requires any modification of the insurance approved by ORR pursuant to paragraph 1, the licence holder shall, no later than 60 days (or such longer period as ORR may approve) from the date of the notice, procure that such modification is made.

4. In this Condition:

"self-insurance" means the licence holder's financial capacity to meet any liability to a third party in respect of which the licence holder does not otherwise have insurance.

### Proposed new licence condition:

#### Insurance

1. The licence holder shall, in respect of licensed activities, maintain insurance against third party liabilities in accordance with any relevant ORR general or specific approval, as amended from time to time.





## Annex C: Consultation questions

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### Chapter 3

- Q1 Do you agree the requirement not to exclude computer data change risks from public liability insurance policies can be deleted?
- Q2 Do you agree the scope of public liability cover required should otherwise be left unchanged, and that there is no need to specifically include terrorism?
- Q3 Do you agree the default *minimum* amount of public liability cover required should be reduced to £100m per incident?

### Chapter 4

- Q4 Do you agree we should replace the current insurance guidance with a shorter general approval? Do you have any comments on the proposed general approval at Annex A?
- Q5 Do you have any comments on the simpler new licence condition at annex B?
- Q6 Do you agree that operators should *not* routinely need to send details of their insurance arrangements to us for approval?
- Q7 Do you agree ORR should target its monitoring and approval work on new entrants, and a rolling programme of risk-based auditing?

### General

- Q8 Are there any other insurance-related issues you would like to raise?