



OFFICE *of the*
RAIL REGULATOR

**GUIDANCE ON INSURANCE AGAINST
THIRD PARTY LIABILITY –**

A CONSULTATION DOCUMENT

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Regulator's foreword

1. The licences granted to operators of trains, stations, networks and light maintenance depots require the licence holder to maintain insurance (including self-insurance) against third party liability. The licences also require that such insurance should be held on terms approved by me. I regard my approval role as providing important protections for the public and other parties who use the railways.
2. The minimum requirements for third party liability insurance are set out in the *Guidance on Insurance Against Third Party Liability*. This document has seen a number of changes since the first edition was published in 1994 and in 1996 I instituted a formal consultation process for dealing with future proposed changes to the insurance guidance. The current edition is dated January 1997.
3. This consultation document seeks views from industry parties, insurance brokers, insurers and others with an interest on this year's proposed changes to the insurance guidance. In addition to proposed changes in relation to the extent of 'on occurrence' cover required, 'Year 2000' exclusions and requirements in relation to international licences granted by the International Rail Regulator, this consultation document proposes changes to the way in which licensees quantify their exposure under their self-insurance proposals. The opportunity has also been taken to provide an update on the outcome of the CAHA Review referred to in the last consultation and progress on the review of arrangements for 'privately-owned rail vehicles' carried out by my Office.
4. I welcome comments from anyone with an interest who feels they wish to contribute.

JOHN SWIFT QC

Rail Regulator and International Rail Regulator

1. Introduction and summary

Introduction

- 1.1 The 'domestic' licences granted by the Rail Regulator ('Regulator') and the Secretary of State¹, together with the international licences granted by the International Rail Regulator (IRR), contain a condition requiring the operator to maintain insurance against third party liabilities in respect of licensed activities on terms approved by the Regulator. The Regulator has published guidance ('insurance guidance') indicating the minimum requirements which must normally be met in order to obtain approval.
- 1.2 Since the current edition of the insurance guidance was published in January 1997, a number of significant issues have arisen which the Regulator has decided need to be covered by the insurance guidance. This consultation has two main objectives:
- (a) to seek the views of all those with an interest on the proposed amendments to the current edition of the insurance guidance to ensure that any changes made are fit for purpose; and
 - (b) to describe progress in a number of related areas likely to be of interest to consultees.

The Consultation Document

- 1.3 Section 2 describes the proposed changes to the existing insurance guidance and explains the Regulator's reasons for proposing them.
- 1.4 Section 3 sets out the Regulator's proposals for keeping the insurance guidance under review and describes developments in establishing a forum for the railway and insurance industries to discuss matters of mutual interest.
- 1.5 Section 4 describes the outcome of the review of the Claims Allocation and Handling Agreement ('CAHA').
- 1.6 Section 5 describes progress on the Regulator's review of insurance arrangements for so-called 'privately-owned rail vehicles'.

¹ Also a limited number of licence exemptions granted by the Regulator

- 1.7 A copy of the current insurance guidance highlighting proposed modifications (additions in italics and deletions struck-through) is attached at Annex A.

Next Steps

- 1.8 Following the end of the consultation period the Regulator will review the insurance guidance (also the guidance on licensing where necessary) in the light of the comments received. He may wish to contact some consultees to clarify comments and gain further understanding of the issues raised.
- 1.9 The Regulator will aim to issue the revised version of the insurance guidance by the end of December 1998.

Consultees

- 1.10 The Regulator will send copies of the Consultation Document inviting comments to:
- (a) all holders of 'domestic' and international licences;
 - (b) all insurance brokers acting for licence holders;
 - (c) all current applicants for 'domestic' and international licences;
 - (d) the insurance brokers to the Central Insurance Facility;
 - (e) Railway Claims Ltd;
 - (f) Office of Passenger Rail Franchising;
 - (g) Association of Train Operating Companies;
 - (h) ROSCOs;
 - (i) Private Wagon Federation;
 - (j) Rail Freight Group;
 - (k) British Railways Board;
 - (l) Health & Safety Executive;
 - (m) Central Rail Users' Consultative Committee;

- (n) Insurance industry representative bodies (Association of British Insurers, Lloyd's Underwriters Non-Marine Association Ltd, British Insurance & Investment Brokers Association and Institute of Insurance Brokers);
- (o) other insurers or insurance brokers who have expressed an interest;
- (p) the Institute of Chartered Accountants in England and Wales - and other accountancy professional bodies; and
- (q) any others who express an interest.

Address for responses and dates

- 1.11 Comments in response to this consultation should be sent in writing to arrive at the following address no later than 7 December 1998:

Diane Ross
Office of the Rail Regulator
1 Waterhouse Square
138-142 Holborn
London
EC1N 2TQ

- 1.12 Unless it is clearly stated by the consultee that a response has been provided on a confidential basis, responses will be placed in the ORR's library and may be quoted publicly.
- 1.13 Additional copies of this document are available free of charge on request from the Office of the Rail Regulator Library. Telephone (0171) 282 2001; Fax: (0171) 282 2045; E-mail: orr@dial.pipex.com; or write to The Librarian at the address shown above.
- 1.14 Most ORR/IRR publications are also available at the ORR/IRR web site, which is at: <http://www.rail-reg.gov.uk/>

2. Proposed changes to the insurance guidance

Changes to the format of the insurance guidance

- 2.1 The insurance guidance shown in Appendix A includes a number of proposed format changes. These have been made in response to comments from users and aim to clarify the structure of the insurance guidance by introducing section headings as follows:
- (a) the Regulator's and the IRR's roles and objectives in relation to third party liability insurance;
 - (b) general requirements in relation to insurance policies;
 - (c) general requirements in relation to self-insurance;
 - (d) special requirements for holders of international licences;
 - (e) how to obtain the Regulator's or the IRR's approval of insurance policies and self-insurance arrangements; and
 - (f) keeping the guidance under review and further information.
- 2.2 The opportunity has also been taken to add a glossary of abbreviations and to separate the check list from the main part of the text so that it can more easily be used in connection with applications. A number of minor clarifications and expansions have also been added. In general, however, the format changes have been achieved by introducing new headings and it has not been necessary to change the text or its order.
- 2.3 The Regulator invites consultees' views on whether the proposed changes to the format of the insurance guidance are helpful and whether there is anything else which should be done to make the document clearer and easier to use.

Insurance policies with a duration of more than one year

- 2.4 The insurance guidance says nothing about what the Regulator would do if he were asked to approve an insurance policy with a duration of more than one year. While there may be financial or other benefits to the licence holder in buying such insurance, the Regulator would need to ensure that any approval given in these circumstances

was consistent with his objectives in relation to third party liability insurance and his wider duties under section 4 of the Railways Act 1993.

- 2.5 An important issue is whether it would be possible for such insurance policies to be modified should a later consultation exercise result in changes to the insurance guidance. Where modifications could not be procured following a change to the insurance guidance during the currency of a multi-year approval, there would be a serious risk of non-compliance with the Regulator's new requirements and the creation of an inconsistent approach to insurance across the railway industry.
- 2.6 The licence condition provides a mechanism allowing the Regulator reasonably to require licence holders to procure modifications to approved insurance. However, the Regulator does not consider it would be appropriate to use his licence enforcement powers as a matter of course in connection with routine insurance approvals.
- 2.7 As a result of these concerns, the Regulator is proposing that he would not normally approve insurance policies for more than one year at a time unless he could be sure that the licence holder would be able to procure changes which might be necessary as a result of subsequent changes to the insurance guidance. The resulting proposed amendment to the insurance guidance is shown in paragraph 1.4 Appendix A.
- 2.8 The Regulator invites consultees' views on the desirability and practicability of the proposal, including the wording in the draft insurance guidance, that he should not normally approve insurance policies for more than one year at a time.
- 2.9 The Regulator would be interested to hear from consultees whether there are any special circumstances in which a longer approval might be appropriate, bearing in mind the concerns set out in paragraphs 2.5 to 2.6 above.

The International Rail Regulator's insurance requirements

- 2.10 The Railways Regulations 1998 create a new role for the International Rail Regulator ('IRR') in granting and ensuring compliance with international licences for railway undertakings established in Great Britain. The IRR has published a general description of his licensing and access functions². He has also consulted on more detailed guidance ('international guidance') on what is required to obtain an international licence³.

² *The role of the International Rail Regulator* – July 1998

³ *Guidance on licensing of international railway operators* July 1998 (draft for consultation)

- 2.11 The IRR has essentially the same requirements of operators' third party liability insurance as the Regulator, but he additionally requires that international licence holders must ensure their insurance policies do not contain a territorial exclusion which means that any provision in any policy is not in accordance with the law of any of the countries in which the licence holder operates or proposes to operate and do not exclude liabilities under the provisions of COTIF and other relevant law.
- 2.12 The proposed amendments to the insurance guidance shown in Appendix A reflect:
- (a) the IRR's role in approving third party liability insurance held by holders of international licences; and
 - (b) the additional requirements on holders of international licences (section 5) over and above the requirements on 'domestic' licence holders.
- 2.13 The IRR invites views from consultees on the proposed changes to the insurance guidance reflecting the IRR's insurance approval role.**

The 'Year 2000 Bug' computer date change problem

- 2.14 The Regulator has been asked whether he would approve insurance policies which excluded liabilities arising from incidents resulting from computer date change problems⁴ (the so-called 'Year 2000 Bug').
- 2.15 From his discussions to date, the Regulator understands that the most serious risk of exclusions lies with those companies which have not taken appropriate steps to manage the risk of failures as a result of Year 2000 problems. The Regulator has taken an active role in promoting awareness of Year 2000 problems and has encouraged both the development of the Rail Millennium Project Office and all licence holders to make use of its services. The Regulator considers it is vital for all licence holders to demonstrate to their brokers and insurers that they have been taking appropriate steps to manage the risk of Year 2000-related incidents.
- 2.16 In the light of what he has seen so far, the Regulator does not consider it would be appropriate for him to approve insurance containing exclusions in relation to incidents resulting from computer date change problems unless there were very substantial changes from the current situation (see paragraph 3.2 of the proposed amendments to

⁴ Although attention has frequently focused exclusively on problems occurring at the Millennium, the Regulator understands that certain other dates used in computers (*e.g.* 9 September 1999) may also cause problems. The comments in this section should therefore be taken to relate to all computer date change problems not purely those occurring at the Millennium.

the insurance guidance in Appendix A). To do so would run directly counter to the Regulator's stated objectives, in particular the protection of the interests of third parties. The Regulator will, of course, continue to keep this issue closely under review.

2.17 The Regulator invites consultees' views on his proposals in relation to Year 2000 exclusions in licence holders' insurance policies.

Basis of cover

2.18 The current edition of the insurance guidance requires cover up to £60 million to be on an 'occurrence' basis and states that it is generally acceptable for cover in excess of £60 million to be on a 'claims made' basis.

2.19 The Regulator's basic premise is that the 'on occurrence' basis of cover is best, as this provides the best available protection to third parties. When he first approved licence holders' insurance policies, 'on occurrence' cover did not appear to be available from the market for the levels above £60 million at an economic rate and the Regulator agreed that it would be acceptable for cover at these higher levels to be on a 'claims made' basis.

2.20 It now appears that 'on occurrence' cover is available from the market up to the £155 million required by the Regulator. Consequently, the insurance guidance in Appendix A includes (paragraph 3.6) a proposed requirement that all cover should be on an 'on occurrence' basis.

2.21 One of the Regulator's key objectives in relation to his insurance functions is to ensure that operators provide and maintain sufficient cover to protect third parties. Some insurance policies are structured such that the cover provided is eroded as claims are met. This could result in cover not being available to meet claims. In order to avoid this undesirable situation, the Regulator requires licence holders to be able to demonstrate that full cover will be maintained. This is not a new requirement, but the insurance guidance in Appendix A now includes a new paragraph (paragraph 3.7) to reinforce this important point.

2.22 The Regulator invites consultees' views on his proposal that all cover should be on an 'on occurrence' basis.

Self-insurance

- 2.23 The current procedure for seeking the Regulator's approval of self-insurance requires operators to quantify their self-insured exposure and to confirm their ability to meet it. Quantification may either take the form of an aggregate cap on self-insured liabilities or a statistical analysis of third party risk. An aggregate cap is normally required where it is not possible to establish a satisfactory statistical analysis of risk. Confirmation of ability to meet self-insured liabilities is normally required to be in the form of a certificate from the operator's directors, accompanied by a statement from the operator's auditors.
- 2.24 Following a representation made by one of the accountancy professional institutions, the Regulator is concerned that the statistical approach in the existing procedure for quantifying potential liabilities does not provide a firm quantification of risk - it shows an 'expected' outcome in a 'normal' year, but the worst case outcome could be far worse. Within the context of the going concern review auditors would have no reason to assume future risks would be greater than those reported and met in the year of the financial statements. In these circumstances, the relatively limited form of statement required from the auditors actually gives little comfort to the Regulator that, should worst case claims scenarios materialise, the licence holder would actually be able to pay claims made against it. Furthermore, some firms of auditors might be unwilling to make any such statement at all.
- 2.25 One possible solution to this problem might have been to require auditors to provide a statement within special defined terms. However, the Regulator is aware that such procuring such statements can be expensive and there remains the fundamental difficulty that he would still receive little comfort that, should worst case claims scenarios materialise, the licence holder would actually be able to pay claims made against it. Moreover, commissioning and reviewing such statements would necessarily involve the Regulator in closer scrutiny of the licence holder's financial affairs and potentially those of other companies within its group. The Regulator is keen to implement a solution which will allow him to achieve his objective of ensuring that cover is available to protect third parties while limiting the burden on licence holders to the minimum necessary to achieve this objective.
- 2.26 The Regulator is therefore proposing to remove the statistical analysis of third party risk as an acceptable method of quantification of the licence holder's potential third party liability risk. Consequently, all operators would normally be required to have an aggregate cap on their self-insured liabilities and to give evidence that it was in

place from the date of commencement of insurance cover. The directors' certificate and auditors' statement requirements would remain unchanged. The proposed amendments to the insurance guidance are shown in paragraphs 6.8 to 6.9 of Appendix A.

2.27 The Regulator invites consultees' views on his proposal that an aggregate cap should normally be required on all licence holders' self-insurance.

Summary of questions asked

2.28 Views are invited on:

- (a) whether the proposed changes to the format of the insurance guidance are helpful and whether there is anything else which should be done to make the document clearer and easier to use (paragraph 2.3);
- (b) the desirability and practicability of the proposal, including the wording in the draft insurance guidance, that he should not normally approve insurance policies for more than one year at a time (paragraph 2.8);
- (c) whether there are any special circumstances in which a longer approval might be appropriate, bearing in mind the concerns set out in paragraphs 2.5 to 2.6 (paragraph 2.9);
- (d) the proposed changes to the insurance guidance reflecting the IRR's insurance approval role (paragraph 2.13);
- (e) the Regulator's proposals in relation to Year 2000 exclusions in licence holders' insurance policies (paragraph 2.17);
- (f) the Regulator's proposal that all cover should be on an 'on occurrence' basis (paragraph 2.22); and
- (g) the Regulator's proposal that an aggregate cap should normally be required on all licence holders' self-insurances (paragraph 2.27).

3. Keeping the insurance guidance under review

- 3.1 In his last consultation⁵ document the Regulator proposed a consultative approach to amendments to the insurance guidance. He invited views on the best way to foster an effective dialogue with the industry and other parties with an interest in third party liability insurance. He also asked for views on the prospects for the development of a more competitive insurance market in the future.
- 3.2 At the end of September 1997 there was the first meeting of the Insurance and Railway Industry Focus Group organised jointly by Willis Corroon and St Pauls. The meeting was attended by the Director of Licensing and Consumer Protection from ORR. The purpose of the meeting was to establish a formal industry forum on insurance with a committee and terms of reference. A further meeting of the Group has been held since and it appears to be functioning as a useful forum for the exchange of views between the railway industry, insurance brokers, insurers and the Regulator.

⁵ *Guidance on insurance against third party liability – A consultation document – August 1996*

4. The Claims Allocation and Handling Agreement ('CAHA')

- 4.1 In section 6 of his last insurance consultation document ⁶ the Regulator set out the objectives underpinning the Claims Allocation and Handling Agreement, said that it was due to be reviewed and explained that the review would be the subject of consultation by the Rail Industry Disputes Resolution Committee ('RIDRC'). The Regulator emphasised the importance of CAHA within a disaggregated railway and encouraged rail operators and others to play an active and constructive part in the review.
- 4.2 The RIDRC's review of the operation of CAHA started in Autumn 1996 and reported in April 1997. The report included a number of recommendations for improvement and a proposed staged implementation of the recommendations. Phase 1 amendments approved by the Regulator came into effect on 30 August 1997:
- (a) restructuring of Railway Claims Ltd ('RCL' - the former BR claims department) to allow commercialisation of its claims handling activities while protecting the continuity of quasi-regulatory activities carried on at industry level such as management of the lead party process following incidents involving more than one industry party;
 - (b) clarification of the arrangements for self-handling of claims by industry parties;
 - (c) parties intending to opt out of RCL to give three months notice;
 - (d) a biennial review of the Threshold below which claims are pre-allocated and of the property damage threshold;
 - (e) improvements to Lead Party Arrangements;
 - (f) removal of road motor vehicle claims from CAHA; and
 - (g) referral of property damage disputes to RIDRC rather than mediation.

⁶ *Guidance on insurance against third party liability – A consultation document - August 1996*

- 4.3 Phase 2 amendments came into effect on 1 April 1998 and clarify Lead Party procedures and incorporate a Code of Practice as Schedule 2 of CAHA. Since licensed operators can use any claims handler to handle third party claims, the objectives of the Code of Practice are to:
- (a) protect the interests of claimants by setting out a consistent minimum standard of service to be provided by CAHA parties and their claims handlers;
 - (b) explain the role of the Registrar (the quasi-regulatory arm of RCL); and
 - (c) address the rights and obligations of CAHA parties to each other in the context of dealing with third party claims.
- 4.4 Work has still to be completed on a number of recommendations:
- (a) mechanisms to ensure that valid claims are paid to third parties in the event of a licensed operator's insolvency;
 - (b) a central industry database of claims; and
 - (c) rewriting CAHA in plainer English.
- 4.5 The Regulator considers that the implementation of the CAHA review recommendations has resulted in considerable improvements in the way in which CAHA meets his underlying consumer protection objectives in relation to the allocation and handling of claims. The outstanding recommendations are expected to be progressed to completion within the next 6 to 12 months.

5. Privately-owned rail vehicles

- 5.1 In the August 1996 consultation document on third party liability insurance the Regulator stated his intention to initiate a review of the third party liability regime in relation to privately-owned rail vehicles. A number of key issues were identified as needing to be taken into account:
- (a) vehicle registration arrangements;
 - (b) the role of the Railtrack certification regime; and
 - (c) the differences between the arrangements for vehicles owned and registered in Great Britain and those owned or registered elsewhere.
- 5.2 Respondents to the consultation generally welcomed the intention and indicated their willingness to participate in the review. The review covered rail vehicles which fulfilled both the following criteria:
- (a) owned by a company outside the licensing regime of the Railways Act 1993 in relation to such ownership; and
 - (b) operated without the benefit of a lease or other agreement which transfers responsibility and liability for the vehicle to a licensed train operator.
- 5.3 Most of these vehicles are freight wagons, but any passenger coach or other type of vehicle operating on the national network fulfilling the above criteria was also included in the review.
- 5.4 The review has uncovered a number of complex and difficult issues and the Regulator is not yet in a position to announce his conclusions. He intends to hold a separate consultation at a later date, which will give the industry and others with an interest the opportunity to comment on his conclusions and any changes to the current regulatory arrangements proposed as a result.

Annex A: Proposed amendments to the Guidance on Insurance against Third Party Liability

This part of the document is available in hard copy from the ORR Library.

Annex B: Glossary of Abbreviations

CAHA	Claims Allocation and Handling Agreement - arrangements approved by the Regulator as satisfying the requirements of the Claims Allocation and Handling condition in domestic licences
COTIF	Convention relative aux Transports Internationaux Ferroviaires (international law covering international rail transport)
'Domestic' licence	A licence granted by the Regulator or the Secretary of State under the Railways Act 1993 - authorises operation solely in Great Britain
Insurance guidance	Guidance on Insurance Against Third Party Liability (Third Edition - January 1997)
International licence	A licence granted by the IRR under the Railways Regulations 1998 for the operation of international railway services - authorises operation throughout the European Economic Area
IRR	International Rail Regulator
ORR	Office of the Rail Regulator
Privately-owned rail vehicle	A rail vehicle (also referred to by some as 'private wagon') which fulfils both the following conditions:
.	owned by a company outside the licensing regime of the Railways Act 1993 in relation to such ownership; and
.	operated without the benefit of a lease or other agreement which transfers responsibility and liability for the vehicle to a licensed train operator.
The Railways Regulations 1998	Statutory Instrument 1998 No. 1340, which implements Directive 95/18/EC on the licensing of railway undertakings
RCL	Railway Claims Ltd
Regulator	The Rail Regulator
RIDRC	Rail Industry Disputes Resolution Committee
Self-insurance	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
Year 2000 problems	Incidents resulting from computer date change problems - including those occurring other than at the turn of the century