

APPENDIX 1

**INSURANCE AND RISK MANAGEMENT
REVIEW**

February 22, 2010



Auditor General's Office

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EXECUTIVE SUMMARY

In 2009, the City insurance program cost \$44.3 million

In 2009, the total cost of the City's insurance and risk program was \$44.3 million. The City's annual insurance expenditure is comprised of premiums to purchase insurance, payment of claims, claims related costs such as legal, brokerage and adjusting fees, and administrative expenses.

The objective of this audit was to review the adequacy and effectiveness of current practices for the management of the City's insurance and risk management program, with a view to identifying opportunities for improvements and cost savings.

Insurance services centralized for all divisions and most Agencies, Boards Commissions and Corporations

The Insurance and Risk Management (IRM) Section of the Corporate Finance Division is responsible for the administration of the City's property and casualty insurance policies, premiums, self-insurance, claims administration and risk management. IRM provides services to all City divisions, including the Toronto Police Service, and most Agencies, Boards, Commissions and Corporations except Toronto Hydro, Toronto Community Housing Corporation, Toronto Parking Authority and the Toronto Transit Commission.

While it is unlikely that the Insurance and Risk Management Section would be able to accommodate the insurance needs of Toronto Hydro and the Toronto Transit Commission, it may be in a position to do so for the Toronto Community Housing Corporation and the Toronto Parking Authority.

Previous audit reports and comments made by the Mayor's Fiscal Review Panel

In this context, the comments and recommendations contained in a number of previous audit reports and reiterated by the Mayor's Fiscal Review Panel in its February 21, 2008 report entitled "Blueprint for Fiscal Stability and Economic Prosperity - A Call to Action" are of particular relevance.

Potential cost impacts and savings through the inclusion of other Agencies, Boards, Commissions and Corporations

Previous audit reports have recommended the consolidation of many City activities with Agencies, Boards, Commissions and Corporations. In addition, one of the recommendations in the Mayor's Fiscal Review Panel report states that the:

“City should develop a program to require much more coordination, cooperation with shared best practices, and cost sharing between the City and the ABCCs.”

The Insurance program at the City is, in our view an area where this recommendation requires consideration.

We have made a number of recommendations in this report that may impact overall costs. Cost impacts and savings are possible by:

- Increasing levels of self insurance
- Eliminating the current “fronting” agreement
- Increasing staff at the City Legal Department and at the same time reducing the reliance on external legal counsel

Given the complexities of the City's insurance arrangements, we are unable to provide a firm estimate of the cost impacts of addressing certain of the recommendations in this report. Nevertheless, changing staffing levels in the Legal Services Division should result in savings in the range of \$600,000 per year.

Certain other recommendations will increase the effectiveness of the program

The implementation of other recommendations in this report will in our view improve the effectiveness of the Insurance and Risk Management Section. These recommendations include the need to:

- finalize and issue the Risk Management Policies and Procedures Manual
- review authority levels for approving claims
- monitor and address staff delays in providing information to the City's adjusters. Delays in providing information inevitably lead to an increase in adjusters time and costs to appropriately address claims
- review the fee structure of the adjuster.

This report contains 20 recommendations. The review and implementation of the recommendations should be addressed as soon as possible and in particular those areas where potential cost savings may be realized.

BACKGROUND

Insurance services centralized for all divisions and most Agencies, Boards, Commissions and Corporations

The Insurance and Risk Management Section (IRM) of the Corporate Finance Division is responsible for the administration of the City's property and casualty insurance policies, premiums, self-insurance, claims administration and risk management. IRM provides services to all City divisions, including the Toronto Police Service, and most Agencies, Boards, Commissions and Corporations except Toronto Hydro, Toronto Community Housing Corporation, Toronto Parking Authority and the Toronto Transit Commission. IRM is also responsible for monitoring third party providers of services such as insurance brokerage, adjusting and legal.

Processing insurance claims at the City requires the combined involvement and cooperation of the City's IRM staff, the City's third party adjuster, litigation solicitors, both internal and external and the City's insurance companies.

The City insures \$12.5 billion in assets as well as medical malpractice, ferry operations and personal injury

IRM has identified insurance needs such as:

- Buildings and equipment – valued at \$12.5 billion in 2009
- General liability – for occurrences such as personal accidents that occur on City property
- Medical malpractice – for occurrences at Toronto Public Health, Emergency Medical Services, and Long-Term Care
- Automotive – for over 5,000 City owned and operated vehicles
- Marine – for 21 City vessels including ferries

The City is responsible for the first \$5 million on most of its insurance

City staff, in concert with the City's insurance broker Marsh Canada, have determined that the most effective and economical method of insuring the majority of the City's risks is, with some minor exceptions, to self insure for claims less than \$5 million and purchase policies from insurance companies for claims greater than \$5 million. Essentially claims for less than \$5 million are funded by the City.

In 2009, the City insurance program cost \$44.3 million

In 2009, the total cost of the City’s insurance and risk program was \$44.3 million. The City’s annual insurance expenditure is comprised of premiums to purchase insurance, payment of claims, claims related costs such as legal and adjusting fees, and administrative expenses and brokerage fees. Table 1 is a five year summary of these costs.

Table 1: Summary of Insurance Costs 2005 - 2009
\$000’s

Description	2005	2006	2007	2008	2009
Insurance premiums	\$7,499	\$7,470	\$6,595	\$5,849	\$6,152
Insurance Claims paid (net)	15,449	15,630	17,961	12,719	22,735
Legal Fees	5,092	7,686	7,939	9,328	11,321
Adjusting Fees	1,500	1,484	1,488	2,195	2,689
Administrative costs	885	856	951	1,068	1,162
Brokerage fees	167	167	170	173	221
Total	\$30,592	\$33,293	\$35,104	\$31,332	\$44,280

Insurance costs are funded through charges to divisional budgets

In order to cover the costs of the insurance program, City Divisions are charged a proportionate share of the City’s total insurance cost. These amounts are transferred to the Insurance Reserve Fund maintained by the City. Insurance premiums and claims related costs are paid for out of the Insurance Reserve Fund.

\$108 million in estimated outstanding claims

At December 31, 2009, there were over 4,000 outstanding claims with an estimated liability of \$108 million. It is not necessary for the Insurance Reserve Fund to be funded for this full amount. The City’s broker and actuaries advise that it would be prudent to fund approximately one-half of the total estimated liabilities. The City’s Insurance Reserve Fund had a balance of \$34.4 million available to make these estimated future payments.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

Why we did this audit

The Auditor General's Audit Work Plan included a review of the City's administration of the insurance and risk management program. This is the first time this program has been the subject of an Auditor General review. This review was selected based on the importance of the program in the context of risk management at the City and also because of the significant funds expended in the area of risk management.

Adequacy of management control and practices

The objective of this audit was to review the adequacy and effectiveness of current practices for the management of the City's insurance and risk management program, with a view to identifying opportunities for improvements and cost savings.

Audit Scope

The audit scope included a review of:

- risk management practices and procedures
- claims handling, processing, monitoring and reporting
- processes for insurance program renewal
- monitoring of third-party service providers
- use of technology for risk and claims management.

Audit Methodology

Our audit methodology included:

- review of policies, procedures and practices
- interviews with relevant City staff
- examination of insurance claim files and other relevant documents
- review of records and management reports
- evaluation of current management control processes
- review of Council, Standing Committee reports
- review of insurance practices at a number of Canadian and US jurisdictions
- analysis of City's insurance claim database and third-party service provider billings
- discussions with the staff of the City's third party insurance adjusters
- discussions with the City's insurance broker.

Compliance with government auditing standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

A. INSURANCE AND RISK MANAGEMENT POLICY AND PROCEDURE MANUAL

IRM has primary responsibility

The mandate of the Insurance and Risk Management Section, (IRM) is to minimize the City's incidence and cost of risk through loss control/prevention, insurance protection in case losses occur, and claims management when losses do occur. In order to fulfill its mandate, IRM requires ongoing input, assistance and cooperation from the City's operating divisions where the majority of the risks and losses occur. The responsibilities of the Divisions are to recognize and manage the risks, minimize their occurrence and when losses do occur, ensure that claims are dealt with appropriately and expeditiously.

City divisions play a major role

While IRM staff are qualified professionals in risk management, divisional staff have the specialized knowledge of risks within their operations and how to prevent or reduce them. Divisional staff co-operation is crucial in managing claims when incidents do occur, and how this is handled can significantly impact the City's claims cost.

Divisional staff require advice from IRM including how to reduce the City's risks, and guidance on how to respond to adjusters requests for information when losses do occur. IRM's first and formal method of communicating this advice is through a policy and procedures manual. Much of the advice and guidance from IRM to Divisions should be documented in a formal manual.

Policy and procedures manual provides guidance

While IRM has developed a policy and procedures manual, the document has been in draft form for several years and has not been made available as a resource for divisional staff. The manual should be made readily available and circulated to staff as a risk management resource. In order to ensure that the manual is comprehensive, input as to its contents should be solicited from all stakeholder groups, both internal and external.

Recommendation:

- 1. The Deputy City Manager and Chief Financial Officer review the draft Risk Management Policies and Procedures Manual and ensure that it is current, revised to take into account emerging or changed circumstances, reviewed by all stakeholder groups, finalized and widely circulated to all relevant staff.**

B. MANAGEMENT OF INSURANCE - LEVEL OF INSURANCE

City uses an insurance broker to get best value for insurance

To assist it in obtaining insurance, the City engages an insurance broker. Over the years, the City has developed extensive history relating to the factors impacting insurance premiums. It is the responsibility of the insurance broker to provide this information to insurance companies to assist the City to obtain the appropriate level of insurance coverage at a reasonable price.

City self insures for the first \$5 million in losses

It is possible in any environment to insure for almost one hundred per cent of losses. In order to do so would require premiums to be prohibitively expensive. The City for the most part, currently self insures for the first \$5 million of a loss. Losses above this level are covered by insurance policies with varying upper limits such as \$30 million for medical malpractice, \$95 million for general liability and as high as \$500 million for property.

Self insurance level has significant impacts on insurance premiums

Amending the level of self insurance can have significant impacts on insurance premiums and the City's Insurance Reserve Fund. Since amalgamation, the City's self insurance has increased in steps from \$500,000 in 1998 to \$5 million in 2004, remaining at this level to date. Increasing the self insurance level to \$5 million was the City's response to insurance premiums that were increasing significantly in the municipal environment from 2001 to 2004.

Staff have not quantified the potential savings from increasing self insurance

In reviewing documentation relating to the annual insurance renewal process, the issue of increasing the level of self insurance has been considered in general terms by staff. However, there is no documentation available which quantifies the potential insurance premium savings from increased levels of self insurance.

The City could significantly reduce annual insurance premiums by raising the self insurance level by an additional \$5 million. However, given the complexities of the City's insurance arrangements, actual premium reductions can only be determined by obtaining quotes from insurers on any revised insurance requirements.

Increased self insurance means increased risk

Increasing the level of self insurance does, of course, increase the risk of loss to the City. To mitigate the risk, the savings in premiums should be used to increase the balance in the Insurance Reserve Fund. This practice including the need to continue adding to the reserve fund should be reviewed on an annual basis.

While we are not in a position to recommend an increase in the self insurance levels, our preliminary analysis indicates the need for a detailed review of the City's level of self insurance. Options need to be provided to Council in order to allow it to determine the extent of risks they are prepared to accept.

Recommendation:

- 2. The Director, Corporate Finance, in consultation with the City's insurance advisors, evaluate the risks and benefits of increasing the City's level of self insurance. The results of the evaluation be reported to City Council.**

B.1. The Current Liability Insurance “Fronting” Arrangement Costs \$400,000 Each Year

City required to flow its self insurance through an insurance company

While the concept of self insurance up to a certain level is one of the ways of reducing the City’s insurance premiums, there are other administrative costs resulting from self insuring certain claims. Under Provincial law, insurance companies are the only entities entitled to provide insurance. In order to comply with provincial law, the City has chosen to process all its claims through what is termed a “fronting agreement” with an insurance company.

“Fronting” costs \$400,000 per year

Under the fronting agreement, ACE INA is the City’s insurer of record as required for the \$5 million self insurance the City has established. In return, the City fully indemnifies ACE INA from responsibility for any payments under the policy. The annual fee paid to ACE INA for these services approximates \$400,000.

In the documentation supporting the annual insurance renewal, staff and the insurance broker have identified an alternative to the existing fronting agreement. The alternative is similar to a practice which has been in existence since the mid 1990’s at the Toronto Transit Commission.

Fronting fee at the TTC has been eliminated

In simple terms, the Toronto Transit Commission incorporated its own insurance company through which all automotive insurance claims are processed. The TTC Insurance Company Limited, which is a subsidiary of the TTC, is effectively the TTC’s own insurance fronting company. The TTC Insurance Company Limited received a licence in 1994 from the then Ontario Insurance Commission in order to transact the business of automobile insurance in the Province of Ontario. The fronting fee at the Commission has been eliminated.

Full assessment of eliminating the need for fronting needs to be done

There are legal, audit and business issues and costs that need to be fully analyzed before making a determination as to the viability of the above option. However, the fact that the City is paying almost \$400,000 per year, merely to use the name of a third party insurer, would suggest that this avenue be fully explored. In view of the experience of the Toronto Transit Commission, consultations should be held with the Commission to determine the possibility of proceeding.

Recommendation:

- 3. The Director, Corporate Finance, review the possibilities of changing the current insurance fronting arrangement. Such a review include consultation with staff of the Toronto Transit Commission.**

C. CLAIM HANDLING AND PROCESSING

Five stages to processing claims

The claims handling process consists of five basic stages. These are:

- IRM/City Clerk’s receiving notification of a claim (either from within the City or from external third parties)
- claims adjusting, (i.e., determining if liability exists and if so estimating the amount)
- a decision to defend or settle the claim
- the payment of the claim
- claims analysis to reduce the potential for future claims.

C.1. Claims Notification

Claims are generally made by City Divisions and by external third parties.

Regardless of how or where a claim originates, the claim must be reported to the City’s third party adjuster. Our review indicates that the adjuster is being advised of claims by City staff on a timely basis.

Third parties do not always provide timely notification of claims to the City

When the claim is being reported to the City by a third party, claims notification is not always timely. In these situations, it is sometimes difficult for the adjuster to conduct an investigation if the claim is significantly delayed. For example, in the case of incidents related to slippery sidewalks, conditions may have changed subsequent to the time of the incident.

To afford the City some protection from delays in reporting claims, section 42(6) of the City of Toronto Act, 2006 provides that certain claims related incidents must be reported to the City “*within 10 days after the occurrence of the injury*”. However, section 42(8) of the Act provides certain discretion to judges in granting exceptions to the timelines as follows:

“Failure to give notice or insufficiency of the notice is not a bar to the action if a judge finds that there is reasonable excuse for the want or the insufficiency of the notice and that the City is not prejudiced in its defence.”

C.2. Claims Adjusting

Adjusters make initial decisions on claim validity

Each claim received by the City is assigned to an adjuster. An adjuster’s responsibility is to determine if a claimant is owed a payment under the City’s insurance policy and estimating the amount of payment that is appropriate in the circumstances. To fulfill this responsibility the adjuster may:

- interview the claimant, witnesses and City staff
- review documents such as photographs of the scene, claimant medical records and police reports
- where City liability exists, negotiate a settlement with the claimant
- where a satisfactory negotiated settlement cannot be reached, provide information and support to the City’s lawyers.

Majority of claims handled by third party insurance adjuster

The majority of third party liability, automobile accident benefit claims and large City property damage claims are assigned to the City’s third-party insurance adjuster, McLaren Canada. Third party liability claims against the police, defamation claims and other high profile claims are generally handled by staff of IRM.

To ensure both City and McLaren’s staff can deal with the majority of claims on an expeditious basis, the Insurance Claims Administration Procedures approved by City Council provides for certain dollar limits where staff can take action without requiring further approval as noted below.

Table 2 - Authority Limits for Settling Claims

Authorities for approving claim settlements were established in 2000

Position	\$ Limit
IRM adjusters	\$5,000
McLaren’s adjusters	\$10,000
City senior examiner (IRM staff)	\$25,000
City claims coordinator (IRM staff)	\$50,000
City CFO and Manager IRM or designate in conjunction with the Claims Review Group	Up to the City’s insurance deductible (currently \$5 million)

The limits on the authority to settle claims were established in early 2000. The financial authority levels at that time, according to the staff, reflected “the best practice in order to effectively handle the volume of claims requiring processing”. Subsequent to 2000, the agreement with the third party adjuster has been changed to provide their account manager authority to settle claims up to \$25,000. The procedures have not been changed to reflect this amendment. Further, the remaining authority limits have not been changed for approximately 10 years.

Recommendation:

- 4. The Deputy City Manager and Chief Financial Officer review and, if appropriate, recommend to Council revisions to the delegated financial authority limits for the settlement of insurance claims.**

C.3. Payment of Claims

In order to review the management of the City’s claims handling procedures including the timely payment of claims, we reviewed a sample of 60 files selected from the adjusters outstanding claims list.

Timely information can help control claim costs

One of the first responsibilities of the adjuster involves the collection of information from various sources to substantiate or dispute facts as stated in a claim. Timely responses to requests for information by the adjuster are important not only to the ultimate costs of processing the claim, but to the City’s ability to successfully defend itself against a claim should the need arise.

Depending on the nature of a claim, adjusters require a variety of information from City staff. For example, an adjuster may require road or sidewalk maintenance records, snow removal activities, current photographs of accident sites and policies and procedures related to specific activities. In many files we reviewed, responses by division staff were not supplied to the adjuster on a timely basis.

Claim follow-up by City divisions taking from one to 21 months

Of the 60 files we reviewed, 49 included requests for information from divisional staff. In a number of cases, responses from staff were significantly delayed. Response time frames for the 49 files were as follows:

- Ten requests responded to within one month
- Twenty-one requests responded to between one and three months
- Nine requests responded to between three and 12 months
- Nine requests responded to between 12 and 21 months

Claims files have many notations as to delays in receiving information from City staff

Based on our analysis, in over 18 per cent of the files we reviewed it took staff over 12 months to respond to requests for information. In addition, there were a number of notations made by McLarens in the files concerning the delays such as:

- “Still waiting for report”
- “No report received to date”
- “RUSH message left re missing report”
- “Adjuster waiting to hear from City – reminders sent June 25, Sept 11, 14, Nov. 14 – still no response”.

Need to track and analyze response times

Response time to insurance adjuster requests for information is not tracked and measured. Analyzing response times by division would provide information necessary to identify those Divisions where the major problems exist. Action could then be taken to remedy the problems identified.

Recommendation:

- 5. The Director, Corporate Finance, establish a process to monitor City divisional response time to insurance adjuster requests for information and report results to Divisions where significant delays occur. The City Manager take appropriate action if response times are not appropriately addressed.**

IRM monitor performance of the adjuster on a file by file basis

IRM staff are familiar at some level with the progress of each insurance claim. Staff are consequently aware of situations where adjusting time, or progress on a file, is not proceeding expeditiously. In such cases, staff take appropriate action to ensure files are completed on a timely basis.

High level analytical review required

What is currently absent in the City is higher level analytical review of adjusting time for different types of cases and different adjusters. For example, there is no reason why similar cases are not finalized over similar time frames even if the individual adjuster staff is different. Such analysis would allow staff to review performance of the adjuster from a broader perspective. Any anomalies identified should be discussed with the third party adjuster with a view to reducing the overall time and cost required for adjusting services.

Recommendation:

- 6. The Director, Corporate Finance perform regular reviews of the time spent on adjusting services for the same category of claims. Any files which result in an inordinate amount of time and as a result incur excessive costs be discussed with the third party adjuster.**

C.4. Defending and Settling Claims

Legal advice and proceedings are a significant cost and time component of the claims process. Legal services are provided by staff from the City's Legal Services Division supplemented extensively by external private sector legal firms.

IRM staff assign defence counsel as and when required, which is in about 20 per cent of the total claims made. The remaining 80 per cent of claims are less complicated and are finalized without legal involvement.

A Claims Review Group comprised of City staff has been established

To assist in administering claims greater than \$50,000, Council approved Insurance Claims Administration Procedures require the establishment of a Claims Review Group, (CRG). This group is comprised of senior staff from the Legal Services Division, the Director, Corporate Finance and IRM staff. Representatives of the third party adjuster and divisional staff attend as required.

The role of CRG is to review the handling and status of claims and make decisions as to how the City should proceed in order to minimize claims costs and risk to the City. CRG meets regularly to be updated on the status of claims, make decisions on steps to be taken, and recommend settlements with claimants.

Claims greater than \$50,000 in actual costs are reported to CRG

Current procedures require that claims be reported to CRG only when the actual dollars spent, plus amounts for which current approval is being sought, exceed \$50,000. For example, if a serious accident occurred and it was estimated that the total cost to reach a settlement on the claim would be in the range of \$1 million, the claim is only required, to be reported to CRG once the total expended actually exceeds \$50,000.

Procedures be amended so that CRG is advised of claims prior to actual costs reaching \$50,000

As a matter of practice, CRG is informed of claims with significant estimated total costs prior to the \$50,000 threshold being reached. However, it would be prudent to formally review the threshold for reporting claims to CRG. This would ensure that the group is given early notice of significant pending claims that have not necessarily reached the \$50,000 limit. Formalizing this earlier notice would allow CRG to provide guidance, as necessary, earlier in the life cycle of significant claims and potentially reduce the total cost to the City.

Recommendation:

- 7. The Director, Corporate Finance, review the financial thresholds for reporting insurance claims to the Claims Review Group.**

C.5. Action is Being Taken to Reduce Claims Made Against the City

Although insurance claims generally arise out of accidental events, they often provide information helpful in preventing similar events in the future. This is one key step in a loss control process.

All staff are responsible for identifying loss control opportunities.

Loss Control Notices provide information to staff to help reduce future claims

In recognition of these responsibilities, IRM has developed a process for issuing Loss Control Notices (LCN) throughout the City. Effectively, LCNs provide information on insurance claim details and settlements to ensure that appropriate action is taken to reduce or eliminate the City's exposure to a similar loss in the future. The CRG also has authority to issue LCNs to divisions. LCNs can be for information only or can require that divisions report back on actions taken to mitigate potential future losses. A LCN can be issued to a specific division or City wide.

The LCN process has not been working as intended. We identified instances where LCNs were not issued as directed by CRG, required responses were not provided by divisions, and there was a general lack of follow up on outstanding LCNs.

Recommendation:

- 8. The Director, Corporate Finance, review the Loss Control Notice process to ensure all Notices are issued when required, divisional responses are received and progress on corrective action is monitored by Insurance and Risk Management staff.**

Insurer reviews risks at a sample of City facilities

The City's property insurer, FM Global, performs annual loss prevention reviews at City facilities. Since the City has a large number of facilities, only a sample of facilities is reviewed each year. The intent of this process is to identify risks that could result in a loss to the City and to offer suggestions on how to reduce or eliminate the risk.

FM Global's loss prevention recommendations are provided to IRM and divisional staff for their response and action where appropriate. IRM staff have access to FM Global's database of all recommendations and the divisional response to each recommendation. Recommendations are marked as closed after divisional staff and/or FM Global confirm that a recommendation has been completed.

Record keeping on action taken on insurer's risk assessment recommendation could be improved

The database of loss prevention recommendations contains many recommendations that have not yet been closed. Responses to recommendations include comments such as, "will study corrective action", "action to be taken", and "no action planned". The failure to close these recommendations leaves it unclear as to the nature of any risk assessment undertaken by staff and whether or not action should be taken and if so, when?

To better manage the loss prevention recommendations from the insurer, it would be advantageous to highlight those recommendations where action must or will be taken. Recommendations that will not be implemented either because they are impractical or not cost-effective should be identified to ensure they are not repeatedly reviewed.

Regardless of the approach taken, IRM should review the loss prevention recommendation database regularly. This review should ensure that identified risks have been satisfactorily addressed, recommendations are being closed when appropriate action has been taken, and an action plan exists for open recommendations.

Recommendation:

- 9. The Director, Corporate Finance, ensure appropriate action is taken on loss prevention recommendations identified by the insurer. For recommendations not addressed, specific reasons for not doing so be documented and approved in writing.**

D. LEGAL SERVICES FOR INSURANCE CLAIMS

Demand for legal services is increasing

The increasing demand and limits on existing internal legal resources have resulted over the years in a significant increase in use of legal resources, both internal and external.

To put the cost of legal services in perspective, the table below shows the relationship between legal costs and total claims costs for the past five years.

Table 3 – Comparison of Legal Costs to Claims Costs 2005 - 2009
\$000's

	2005	2006	2007	2008	2009
Claims costs (net of recoveries)	22,041	24,800	27,388	24,242	36,745
Cost of legal services	5,092	7,686	7,939	9,328	11,321
Legal costs as a percentage of claims cost	23.1%	31.0%	29.0%	38.5%	30.8%

The significant increase in costs in 2009 is attributed to severe winter weather in late 2008 and early 2009. This increased claims activity, as well as increases in Human Rights complaints, has also driven legal costs higher.

D.1. An Opportunity to Reduce Costs by Providing More Services In-House

The extent of legal costs charged by private sector legal firms in 2009 represents approximately 77 per cent of the total legal costs to defend certain insurance claims. For external legal services, the City conducted a competitive procurement process that resulted in eight law firms being placed on retainer.

The City Legal Services Division has the equivalent of approximately 13 full-time lawyers providing legal services related to insurance claims.

An analysis of Legal Services costs relating to insurance claims for the past five years is as follows:

**Table 4 – Total Legal Services Costs
Years 2005 to 2009
\$000's**

Year	City Legal Services	External Legal Services	Total
	\$	\$	\$
2005	751	4,341	5,092
2006	688	6,998	7,686
2007	1,083	6,856	7,939
2008	1,796	7,532	9,328
2009	2,625	8,696	11,321

In 2005, City Solicitor presented a business case supporting need for additional legal staff

In late 2005, the City Solicitor reported to the then Administration Committee that cost savings could be realized by performing more insurance related work internally. At that time, it was reported that hourly rates for external lawyers were in the range of 75 – 100 per cent more than hourly rates for lawyers employed directly by the City. The report estimated that the net savings for adding one lawyer assigned to insurance work would be \$156,000 per year.

As a result of the 2005 report, City Council approved the addition of two lawyers to internal staff. The financial impact of this decision was realized in 2007 and subsequent years. In 2007, even though total legal costs continued to increase the level of the increase was significantly less than years prior and subsequent to 2007. An additional lawyer was added to the Division's staff in 2009 to focus on human rights defence work.

Increasing demands for legal services require an update to the City Solicitor's 2005 analysis.

In our discussions with staff of IRM and City Legal, we have been advised that there is a significant amount of legal work assigned to external private sector law firms that could be completed internally if staff were available.

A business case analysis similar to the one conducted in 2005 should be prepared by the City Legal Services Division. In addition to obvious costs such as salary and benefits, the analysis should include costs such as office space, support staff, computer equipment and other support.

Net savings of \$600,000 possible

Our preliminary estimate indicates that there appears to be sufficient insurance related work to justify adding four lawyers to the City's legal division. The addition of four lawyers should result in a net saving to the City of approximately \$600,000 each year through a reduction in fees paid to private sector law firms. Our estimates are preliminary and should be validated through detailed analysis.

Recommendation:

10. The City Solicitor in consultation with the Director, Corporate Finance, prepare a cost-benefit analysis to determine if it would be advantageous to transfer a certain level of legal services currently provided by external private sector legal firms to internal solicitors. Such an exercise be conducted prior to the next City budget cycle.

D.2. Cost and Control of Services Provided by External Legal Firms

A review of various billings for the five external legal firms with the highest billings indicates there is a broad range in the two critical components of legal costs, the hourly rate and the average amount of time spent on a file. Consequently, it is important that legal costs are reviewed to ensure the costs per file are controlled to the extent possible.

Legal costs on individual claim files may be reviewed at three levels

Legal expenses are reviewed at several levels of the claims process. First, the adjuster on each claim file is responsible for minimizing the total cost of the claim. The second point of review is IRM staff who review quarterly billings from the legal firms and also informally monitor costs per claim. Thirdly, the CRG reviews claims where costs have exceeded \$50,000. The CRG review includes analyzing the different components of the costs, including legal expenses.

Staff review legal billings on a sample basis

IRM receives in the range of 1,400 legal billings every calendar quarter and has taken a risk based approach to reviewing the billings. The billings are received electronically and IRM sorts them by dollar value to ensure high dollar billings are more closely scrutinized. While the complete listing of billings is scanned, not every bill is checked in detail. A sample of billings are reviewed ensuring that a representative numbers of billings from each legal firm are reviewed.

The existing process appears to be effective given the nature of the billings and the resources that would be required to perform detailed reviews on 100 per cent of the invoices. These practices provide a certain level of assurance that legal costs on individual claims are being reviewed on a regular basis. However, further review should include some analysis of legal expenses to identify any potential broader issues not evident from the review of individual files.

Higher level analytical review of legal services is warranted.

The analysis should be done for each legal firm, and potentially for each lawyer within a legal firm. The review should include items such as average hourly rate, average hours per claim, legal costs per claim and total cost per claim. The information necessary for these reviews is readily available. Reviewing the data will enhance the ability of IRM management to complete comparative analysis of the relative performance of legal service providers and take corrective action where appropriate.

Recommendation:

11. The Director, Corporate Finance, consider the development of a process whereby all legal bills are analyzed and scrutinized on a performance review basis. Such a process include evaluations of time spent on specific legal files, the level of lawyer expertise assigned to each file along with review of hourly rates. The review process be documented along with evidence of any follow up on apparent irregularities.

E. INSURANCE ADJUSTING

E.1. Review of Existing Fee Arrangement

McLarens Canada has provided claims adjusting services for the City since the 1998 amalgamation of the former municipalities. These services were obtained through a request for proposal process. McLarens' current contract extends to December 31, 2011. Adjusting services are also provided by City staff.

External adjusting costs over the past five years are as follows:

**Table 5 - Insurance Adjusting Fees from 2005 to 2009
\$000's**

	2005	2006	2007	2008	2009
Adjusting fees	\$1,500	\$1,484	\$1,488	\$2,195	\$2,689

Fees charged are a mixture of flat rate and time and expense

The contract with the insurance adjuster is two-tiered. Less complicated claims are billed on a flat rate based on criteria agreed to between the City and the adjuster. More complex claims are billed to the City based on the time spent on the claim. In these cases, IRM staff review adjusting fees on individual files to ensure the charges are reasonable based on issues specific to each claim.

Experience on flat rate files indicates that converting these files to time and expense files could reduce costs in some cases but increase costs in other cases. While these differences appear to offset each other, the experience with these flat rate files may be able to be used to the City's advantage to achieve some limited cost advantage.

Adjusting fee arrangement should be reviewed based on actual experience

The arrangement for a flat fee rate on certain files is just one component of a broader contract that staff feel provides good value to the City but it is prudent to evaluate the arrangement based on actual experience.

Further, in 2009, IRM received budget approval to change staffing to allow more adjusting work to be done by City staff. The changes have not yet been fully implemented.

Recommendations:

- 12. The Director, Corporate Finance, review the current fee structure arrangement with the adjuster in order to determine whether or not there would be cost savings in minimizing flat fee charges.**
- 13. The Director, Corporate Finance, complete the implementation of the Insurance and Risk Management staffing changes approved in the 2009 City budget.**

F. THE RISK MANAGEMENT INFORMATION SYSTEM

IRM uses a purchased software package acquired in 1999 as its Risk Management Information System (RMIS). The RMIS is used to record all claims activity and costs for each claim filed with the City. The system also assists IRM in managing insurance claims and is used for reporting claims to divisions, determining the allocation of costs to divisions, and certain routine claims disclosure to lawyers.

City and adjuster keep separate information systems for claims data

In addition to the City's RMIS, the third party adjuster maintains a database of the City claims files it has been assigned. This database records not only the activity on each claim, but also billings from legal service providers.

Duplicate data entry is inefficient and increases the risk of input errors

Presently, information must be manually input into both the City's and adjuster's information systems. An electronic interface between the two systems is possible, but resources have not been available to implement it. Duplicate data entry increases the risk for data input errors and is inefficient. Resources need to be allocated to implement the electronic interface between the two systems.

Recommendation:

14. The Director, Corporate Finance, in consultation with the Chief Information Officer, interface the Risk Management Information System operated by the City with the claims database managed by the adjuster.

RMIS is not current for the cost of legal services

Approximately 1,400 legal billings received each calendar quarter must be manually entered into RMIS. A data entry backlog means RMIS is not up to date for legal costs. As such, RMIS information related to the cost of legal services is not accurate. Although staff are working on a solution to eliminate the manual entry of this information, it has not yet been implemented.

In addition, IRM does not record the costs for internal staff adjusting services. Identifying and recording these costs would allow for accurate comparisons between the costs of performing this service in house versus through an external provider and against industry benchmarks.

Recommendations:

- 15. The Director, Corporate Finance, complete the implementation of an automated process to update the Risk Management Information System quarterly for the cost of all legal services.**
- 16. The Director, Corporate Finance, consider the need to record, in the claim files, costs related to adjusting services provided by City staff.**

Over the years, significant time, cost and resources have been expended to adapt RMIS for City use.

RMIS capabilities are not being fully utilized

RMIS has the capability to analyze claims trends including the frequency, location and severity of such claims. This information is used extensively during the insurance renewal process. RMIS has significant capabilities that are only beginning to be utilized as needs are identified and staff resources are available for implementation.

Need to include divisional users in the development of RMIS

While a Claims Working Group has been established to guide RMIS developments, it currently only includes staff of IRM and staff from the Information and Technology Division. The Claims Working Group should be expanded to include key divisional users of insurance claim information. The group should be briefed on the capabilities of RMIS and their input sought on standardizing reporting of claims data to divisions to help them manage insurance claims and focus on loss control activities. The group could serve as a steering committee to guide expansion of the use of RMIS to improve information provided to users.

Recommendation:

- 17. The Director, Corporate Finance ensure that user division staff are included in at least an advisory role with the Claims Working Group.**

G. OTHER ISSUES - EXTENT OF RISK TO BE INSURED

The City's list of property locations is known to have some minor omissions

The City has provided a list of property locations to the property insurer FM Global. Both the City and FM Global are aware that there are minor omissions from the list.

The City is currently developing an inventory of all its capital assets along with specific valuations of these assets. While this information is being compiled for financial statement reporting purposes, the information collected will also be useful for insurance purposes.

Insurance policies cover locations not on the list

The current insurance policy contains several provisions to ensure that coverage applies to the few minor locations not listed.

Reports made to Council on insurance coverage but little information on uninsured risks

IRM reports to Council annually on the cost of renewing the City's insurance policies. The report covers all insured risks but does not provide information on uninsured risks such as coverage for environmental damage. While such coverage may not be cost-effective, the information would provide Council with information relating to uninsured risks. This information would allow Council to determine and evaluate the extent of its uninsured risks.

Recommendations:

- 18. The Director, Corporate Finance complete a comprehensive listing of properties and insured values for the 2011 insurance renewal process.**
- 19. The Deputy City Manager and Chief Financial Officer report at least once each term of Council on appropriate relevant information relating to significant uninsured risks.**

H. OTHER OPPORTUNITIES FOR COST SAVINGS

H.1. Previous Audit Reports and the Mayor's Fiscal Review Panel - Inclusion of Other City Entities in City Activities

Potential cost savings through the inclusion of other Agencies, Boards, Commissions and Corporations

Previous audit reports have outlined the potential benefits of consolidating activities performed independently at Agencies, Boards, Commissions and Corporations with the same activities performed by the City.

These potential benefits were also highlighted in the Mayor's Fiscal Review Panel recommending that the "*City should develop a program to require much more coordination, cooperation with shared best practices, and cost sharing between the City and the ABCCs.*"

The insurance program at the City is, in our view, an area where this recommendation requires serious consideration.

IRM is responsible for the City's property and casualty insurance and risk management function and provides these services to all City divisions, including the Police Service and most Agencies, Boards, Commissions and Corporations except Toronto Hydro, Toronto Community Housing Corporation, Toronto Parking Authority and Toronto Transit Commission.

We recognize that the insurance requirements of the Toronto Transit Commission and Toronto Hydro are somewhat unique and their consolidation with the City may not be appropriate or cost-effective. Nevertheless, the consolidation of insurance responsibilities for the other Agencies, Board and Commissions may be cost-effective. In any event, this is an avenue that should be explored.

Recommendation:

20. The Director, Corporate Finance, in consultation with appropriate senior management, consider the cost-effectiveness of consolidating the current City of Toronto insurance program to include certain other City Agencies, Boards, Commissions and Corporations.

CONCLUSION

The objective of this audit was to review the adequacy and effectiveness of current practices of the City's insurance and risk management program, with a view to identifying opportunities for improvements and cost savings.

We have made recommendations to address improvements that will impact the nature and method of obtaining insurance, claims processing, legal costs and information processing systems. Certain of the recommendations may result in cost impacts, although the complexities of the City's insurance arrangements preclude us from quantifying these amounts. Of the recommendations where savings can be quantified, we estimate that savings of approximately \$600,000 per year are achievable.