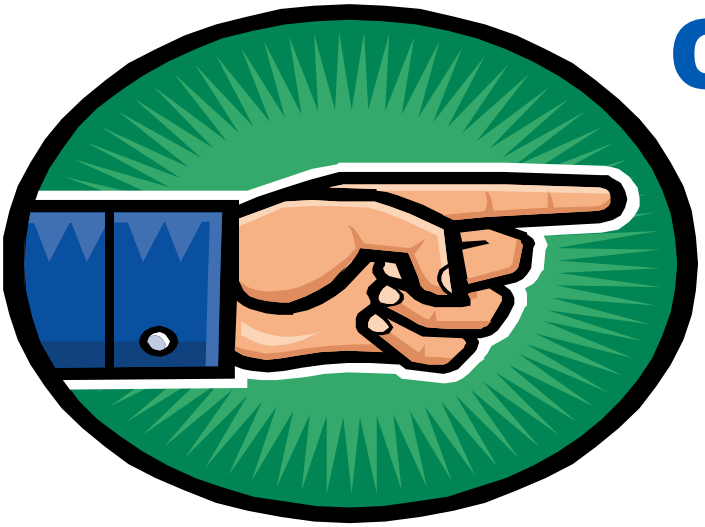
Commercial Insurance Update

Topics Affecting Buyers of Commercial Insurance

MSP C 02/2007 – "Cost of Risk: Who's Managing Yours?" February, 2007



Cost of Risk: Who's Managing Yours?

By Jeffrey W. Cavignac, CPCU, RPLU, CRIS

You won't find a category for "cost of risk" on a company's income statement. However, cost of risk is a huge expense item. Most companies spend 2.5% to 5% of their gross income on risk, and some spend substantially more. In many cases, cost of risk can be the second or third largest expense item on an income statement! In fact, it's estimated that insurance premiums for many firms is 50% or less of the total cost of risk.*

If the cost of risk is such a big deal, why is it so often overlooked? Some aspects of managing risk, in fact, are generally managed pretty well. Most companies try to negotiate their insurance premiums and effectively manage the claims they have. Some even have personnel assigned to be responsible for safety and loss control. Regardless, a more holistic approach and awareness of risk management can substantially reduce your total cost of risk and drive dollars to your bottom line.

Business Risk Versus Hazard Risk

In its simplest terms, "risk management" involves the identification, evaluation, and management of all the potential hazards and exposures to loss a firm may face.

A distinction needs to be made between **business risk** and **hazard risk**. Business risk refers to the risk inherent in the operation of a particular organization. Business risk includes the possibility of gain, no loss, or loss.

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** There is usually a listing for insurance premiums on an income statement, but this is only one element of the total cost of risk.*

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Hazard risk, on the other hand, deals with accidental losses that can cost the organization money. There is no opportunity for gain. Collectively, business risk and hazard risk have become known as **Enterprise Risk Management** (ERM). While ERM is worth pursuing for many large Fortune 500-type companies, it is not realistic for most others. We will focus on hazard risk.

What Is Risk Management?

Whether it knows it or not, every company has a risk manager. In a large organization there may be a Risk Management Department, but in most companies, the risk management function is only one responsibility of an individual's overall job responsibilities. The risk management function is often shared among numerous individuals, and rarely is it coordinated.

In order to effectively manage risk, however, someone – whether it's the chief financial officer, the human resources professional or someone else – should be in charge of risk management. Assuming you have designated such a person, what are the risk manager's responsibilities?

Risk Analysis

Identifying and Analyzing Risk

The first step is to determine what your company's "exposures to loss" are. **Loss exposures** are conditions that could result in financial loss to an organization. From a hazard risk perspective, these conditions generally arise out of property, personnel, liability or net income categories.

Identifying and analyzing risk is the single most important function of the risk manager. If you can't identify your exposures to loss, you can't manage them. Unfortunately, this critical step is often overlooked or performed poorly.

The correct way to identify and analyze exposures is to do so systematically with an exposure analysis program or checklist and, if necessary, the assistance of a risk management professional. (Note: many insurance brokers do not have the expertise to help evaluate exposures to loss – it is important to ally yourself with one that does.)

In addition to completing an exposure analysis program or checklist, you'll also need to review financial statements, flow charts, contracts, etc.

Once exposures have been identified, they need to be analyzed. Some exposures are minimal and can be retained. Others lend themselves to being controlled, and still others will need to be transferred, avoided, or financed. The key is being proactive in this process. It is better to understand your risks and make conscious decisions about how to handle them than to find out at the time of a loss that you are uncovered and unprepared.

Loss Control and Safety

Risk Control

Risk control involves taking steps to minimize either the frequency or severity of a loss exposure. The only real way to lower your total cost of risk is to lower your underlying losses. Money invested to effectively control your exposures and manage the claims you have experienced can generate solid returns.

Some companies maintain their own in-house safety officers or loss control personnel. Many others have assigned this responsibility to an individual who also has other duties. The key is to have one person responsible for these functions. This individual is in charge of conducting inspections of facilities, jobsites, and overall safety. If the individual does not have the expertise to do this effectively, he or she will have to get outside help.

Generally, your insurance company will be able to provide some guidance, but the most logical resource is a "for fee" risk manager, or a capable

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insurance brokerage. Most insurance brokerages do not have dedicated in-house loss control and safety expertise; however, some do, and this can be invaluable.

Collectively, a schedule of services should be developed and responsibilities assigned. This involves participation by the company (insured), the insurer, and the broker (see sidebar for an example).

Claim Management

The best loss control in the world will not eliminate all claims. Effective claims handling procedures can substantially reduce the ultimate costs of claims. Claims need to be reported quickly and correctly. They need to be handled by the right adjusters, and if subrogation is a possibility, it needs to be pursued. Finally, claims need to be monitored and followed up.

The individual in charge of claims needs to make sure that coverage includes how to recognize and report not only actual claims, but circumstances that may give rise to claims. Effective post-accident response training is critical.

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Sample Schedule of Services

Month	Action Item
Months - 4 to -1	➢ Conduct Exposure Analysis ➢ Establish Program Parameters ➢ Perform Loss Control, Claims and Human Resources (HR) Needs Analyses ➢ Marketing
Month -1	➢ Presentation of Solutions and Options ➢ Define Agreed-Upon Schedule of Loss Control, Claims and HR Services ➢ Purchase Insurance ➢ Client Indoctrination ➢ Issue Insurance Binders and Certificates of Insurance (Certs)
Month 1	Program Inception
Month 2	Policy Review and Delivery
Month 4	Workers Compensation (WC) Open Claim Review
Month 6	➢ Mid-Term Stewardship Meeting ➢ Claim Review
Month 7	WC Experience Modification (X-Mod) Projection
Months 9 - 11	➢ Establish Program Parameters ➢ Review Loss Control, Claims and HR Schedule of Services ➢ Marketing
Month 12	➢ Presentation of Solutions and Options ➢ Purchase Insurance ➢ Issue Insurance Binders and Certs

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If a company has any claims frequency at all, a personal relationship with the insurance company's claims adjuster and defense attorney is important.

As a final note, a professional insurance brokerage with dedicated claim personnel should be able to help you effectively manage the claim process.

Risk Financing

After you have identified and analyzed your exposures to loss and implemented risk control techniques to manage the frequency and severity of those exposures, it is time to figure out how to finance the losses that are left. There are two basic options: retention and transfer.

Retention is a risk financing technique by which losses are retained within the organization to pay for losses. Ideally, this is planned, but unfortunately "unplanned retention" is not uncommon.

Unplanned retention is the inadvertent assumption of a loss exposure because it was not identified or correctly analyzed. "**Planned**" **retention** can take a number of different forms. Most common is a **deductible** or **self-insured retention**. Alternatively, it might be an entire exposure that has low severity. Regardless, the firm's ability and desire to retain risk should be evaluated, as it will affect the design of your insurance program.

Risk transfer involves the transfer of risk through insurance, and non-insurance techniques to shift the financial consequences of loss to another party.

Non-insurance risk transfer, as the name implies, involves the transfer of risk to someone other than an insurance company. Usually this is done through a **hold harmless** or **indemnity agreement**. Note that although these are "non-insurance" transfers, typically such agreements are at least partially supported by the indemnitee's insurance program.

Insurance transfers the potential consequences of certain specified loss exposures to an insurance company. Essentially, the insurance company agrees to pay for certain losses in exchange for a premium.

Despite the fact that insurance is often the largest component of the total cost of risk, there is a reason it is the last step in the risk management process.

It is only after you have identified and analyzed your exposures and figured out how you can eliminate, reduce, retain, manage and transfer those exposures that you can figure out what you need to insure. At this point, you are in a position to approach the insurance marketplace with a well-thought-out insurance submission that highlights the attributes of your company's risk management efforts in order to negotiate the correct coverage at a competitive price.

Summary

Cost of risk is a concept many firms have never thought about, despite the fact that it is one of their largest expense items. Regardless of how big your company is, formalizing the risk management function will lower your total cost of risk and drive dollars to your bottom line.

Disclaimer: This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

Building Owners & Managers Association (BOMA) San Diego

URGENT ACTION ALERT:

Back-Flow Preventer Thefts Costing Businesses Thousands!

By Jim Tostado, Hibiscus Investments/BOMA San Diego – Government Affairs Committee Chair
Article Courtesy of BOMA San Diego

Recently there has been a rash of commercial irrigation and domestic water back-flow preventers stolen for their scrap metal. While the scrap metal value for the brass and copper contained within these fittings is only about $250, brazen thieves are making short work of stealing as many as they can, sometimes twice from the same properties.

Back-flow preventers are easily recognized, usually placed above ground along the street frontage for most commercial properties. The "U" shaped pipe acts as a valve to prevent irrigation or other water from "backflowing" into the potable water source for the building.

Most jurisdictions in the County have mandated the use of these valves in commercial buildings. To steal the back-flow preventers, thieves have posed as city employees wearing orange vests and have cut off the valve to the preventers using a saw. The whole process can take less than two minutes.

These thefts have occurred in broad daylight and at prominent and visible locations. Replacing back-flow valves is very expensive, and can cost as much as $3,000-$6,000. Their removal will also interrupt water service for your property, as well as create possible water damage caused by the water running uncontrolled through the open connection.

BOMA is working with local authorities and the recycling/scrap metal industry to stem the tide of these thefts. BOMA has already met with the local waste industry association to brainstorm on ways to notify the public about these thefts in an effort to prevent them in the future.

How to Protect Yourself

Although there is not a perfect solution to eliminate the theft of the units – and, in fact, those who have taken the measures outlined below have still experienced the loss of the valves – the following actions are recommended by law enforcement, landscapers, and plumbers:

- Enclose your backflow valve(s) with a protective cage (if you haven't already).
- Secure it with a tamper-proof lock (A"break-away" lock is easily opened and not recommended). In case of emergency, your maintenance crew should have a copy of the lock's key.
- The cage .should be securely mounted to the ground.
- Have the cage spot welded to the bolts to prevent their removal.
- Stamp, label, or identify the metal with a recognizable code or name of your own.
- Paint the unit(s) with a bright color.
- Post a visible warning sign with something to the effect of "theft and damage to this unit will be prosecuted to the fullest extent of the law."
- Camouflage the unit by planting screening landscape a foot or so from the back-flow. This will make the unit less visible while still allowing for necessary maintenance access.
- Inform your on-site building management, security or other staff of the problem and make sure they keep an eye out for thieves. It is also a good idea to inform your tenants so they can contact you should they see something suspicious near these valves.

BOMA will continue to monitor the issue and pursue actions to curb thefts and catch the criminals stealing these valves. In the meantime, hopefully following these tips should deter the theft of your back-flow units.