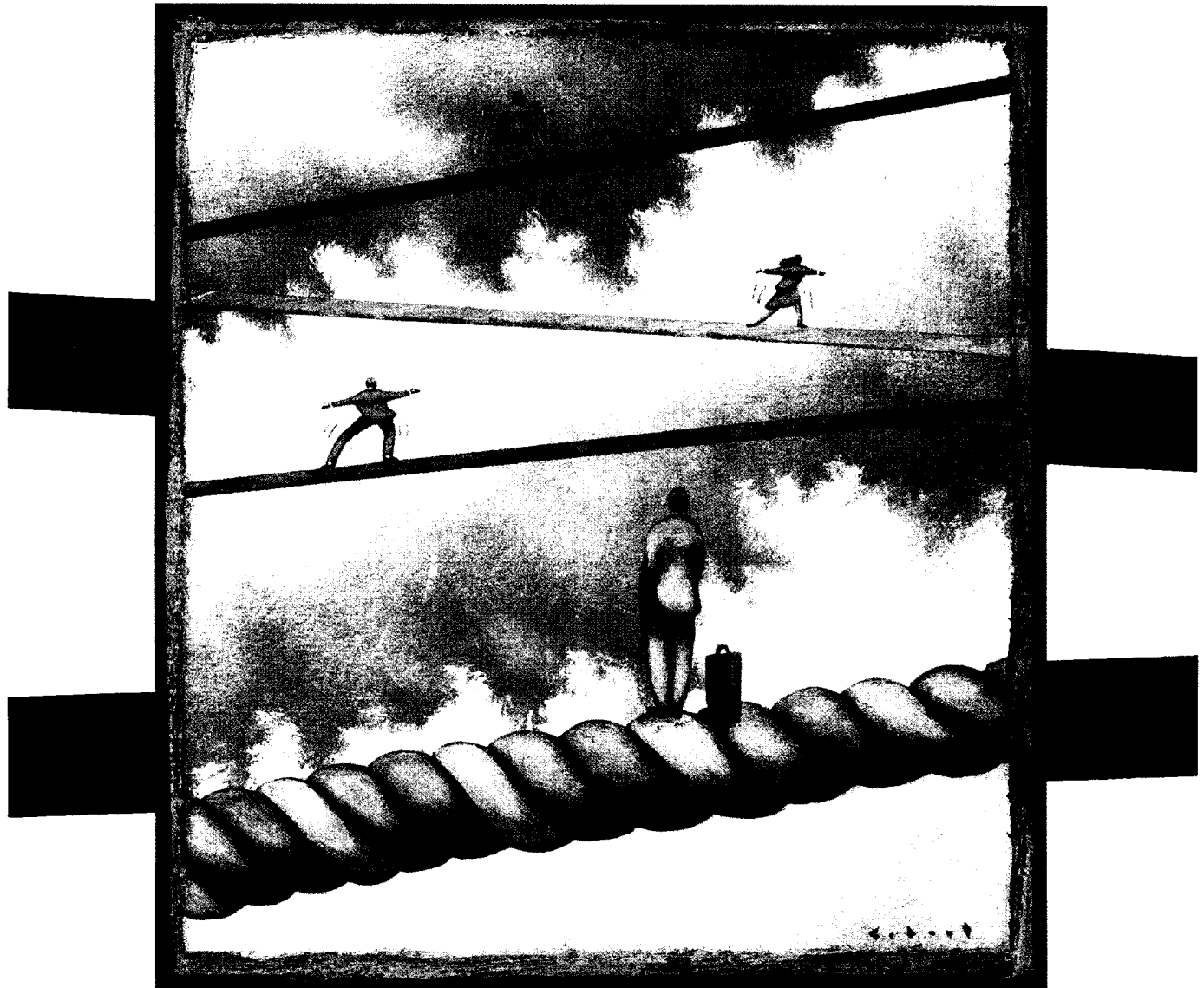


A united approach: Creating integrated risk plans

Wil Thornhill; Amy Derksen

Risk Management; Aug 1998; 45, 8; ABI/INFORM Global

pg. 36



As the various products and approaches used in integrated risk management programs continue to mature, a growing number of risk managers are working with insurers to mold these programs into just about any form their employers need. In fact, the real challenge isn't necessarily in designing the coverage, but rather in identifying the exposures that need to be addressed and defining the best form and level of protection.

Instead of trying to fit clients into existing insurance products or to base their approaches solely on their service capabilities, more insurers are using the customer's exposures as a starting point. In fact, the customized nature of integrated risk programs forces everyone to look at potential solutions from the customer's point of view. The result has

not only been more comprehensive and creative coverage, but also interest from businesses not initially expected to be an audience for integrated risk.

Additionally, it seems that changes in the economy—not necessarily within the insurance industry—are responsible for motivating companies to explore integrated risk programs. Change is occurring at an unprecedented rate as companies examine the ways they manage and conduct business. Even companies that may not have international locations are likely playing on a global scale in some sense, and they have to deal with the risks inherent in currency fluctuations, interest rates and other financial exposures. Add it all up and you have a grow-

A UNITED APPROACH

Creating Integrated Risk Plans

by Wil Thornhill and Amy Derksen

ing group of businesses looking for something more.

For many, integrated risk provides a flexible, long-term structure that's able to withstand a broad array of exposures and events. As an added benefit, companies are realizing substantial savings by combining many risks in one program. Additionally, considerable energy is being devoted to identifying and analyzing non-correlating risks. If it is unlikely that two risk or event exposures will occur at the same time—if they are not related—the insured gets a rate credit.

Consider, for example, a U.S. high-tech firm with international sales whose principal manufacturing facilities are in California and Japan. The earthquake exposures in both locations are significant, but they are not correlated to the firm's potential foreign currency volatility. Therefore, if the earthquake coverage is combined with the company's foreign cur-

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rency protection, there can be considerable savings in its total cost of risk.

Value-Added Advantages

In this soft market, integrated risk is probably not the answer for businesses that base their risk financing decisions on price alone. But for companies with an orientation toward managing their total "enterprise risk," there can be substantial advantages.

First, there are the administrative efficiencies associated with consolidat-

ing capital risk, but the industry's foray into financial protection has opened the door for some interesting solutions to client concerns:

Basket aggregate stop loss options have been around for years, especially during soft market cycles, but they have become a leading benefit of integrated risk programs. Although some lines are not included, such as D&O, political risk or kidnap and ransom, these options provide a cap on the total amount a company retains,

surprising twist in defining the audience for integrated risk plans. While the primary market had always been assumed to be the largest Fortune 500 organizations, a growing number of businesses in the middle market are beginning to raise their hands and attract interest from insurers.

This evolution makes sense. After all, many of these companies have been retrofitting off-the-shelf insurance products to suit their needs. And in most cases, there isn't a full-time

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ing risk. One multibillion dollar microprocessor company was able to combine some 40 different annual policies—with different renewal dates—into a single three-year policy with nine different covers. The integrated program also includes a renewal option for three more years. While the policy is by no means uncomplicated, one of its impressive feats was the ability to reduce the company's total insurance policy word count by more than 60 percent.

Next, consider the peace of mind that long-term coverage can bring. Many three- and five-year policies have provisions stating that the coverage cannot be canceled if a policyholder has an unfavorable loss experience. In addition, annual stewardship meetings assure that the program is adjusted as necessary to reflect current developments in the customer's industry.

Finally, this comprehensive coverage results from a partnership that touches on almost every aspect of the business, including protecting a client's balance sheet and earnings. Naturally, there has been some skepticism about turning to the insurance market in lieu of traditional hedges for

unlike per-occurrence retentions that could reduce a firm's cash flow in a high loss frequency year. Also popular is the move toward a single attachment point for several lines of coverage that allows companies to buy greater capacity very efficiently.

Double-trigger options, typically designed to protect against the simultaneous occurrence of two adverse events, are attractive to corporations with strong balance sheets. The company normally manages each event alone, without insurance, but recognizes that the combination of the two would be detrimental to earnings. For example, the first trigger might be a 20 percent increase in the cost of a key raw material in a fiscal quarter. The second trigger could be a property or casualty exposure that the corporation self-insures or takes a very large retention on. The double-trigger option pays only if the first trigger is met and the second follows within the outlined policy terms. Under this approach, the customer is protected from a double blow, at a fraction of the cost of stand-alone coverage.

Reaching Middle Ground

These latest strategies have led to a

risk manager on staff; the risk management responsibility is generally handled by an executive who divides his or her time among financial and operational functions as well.

For these companies, the idea of a multiyear policy that will substantially reduce administrative requirements is very appealing. They can accept a policy and essentially not worry about it for three to five years. What's more, smaller growth companies are less likely to have the cultural hurdles of a larger firm. The tasks involved in mapping out an integrated program are divided among fewer players, or there's one person at the top who can make the necessary decisions.

In addition, these companies can distill the reporting down to a single parameter that's in sync with what they're already doing for tax reporting or payroll, or they can use internal indices such as the cost of sales or production units. And when the underwriter includes an allowance, so the client isn't penalized with a bigger premium for expected growth, the company is able to budget its annual insurance costs more effectively.

Elizabeth Eiss, executive vice president, middle market and special pro-

grams initiatives of XL America, adds, "Growth companies that are no longer thinking like small companies have begun to realize what they have to gain from enterprise risk ideas. At some point they begin to view risk as the threat to earnings. They begin to view risk as something to manage in an integrated way, and insurance as only one tool to manage risk."

So the best fit for an integrated risk program is determined, perhaps, not by a company's size but by its culture and general attitude toward management and risk.

Looking Ahead

What will be the next step in the evolution of integrated risk? As more insurance providers offer integrated risk management, each is looking for ways to differentiate itself in the marketplace. Some are choosing niches based on their product specialties or the industry classes they serve, while

others think that's missing the point.

Increased competition will continue to push carriers to streamline their processes and improve their knowledge of the financial markets—either by acquiring companies, talent or training, or a combination that involves all three. Additional experience will help carriers and clients standardize the most common choices, reducing the time it takes to implement a fully integrated risk management plan from the current average of a year or more.

More and more quantitative analysis and modeling is being done by insurance companies, brokers and academics to predict risks and price non-correlating exposures—particularly on the financial side of things, which can be easier to predict than traditional property/casualty exposures.

What's more, it's unlikely that the sort of mono-line pricing customers have been enjoying in this soft market

is going to be sustainable. Eventually, other service-based factors or added-value benefits will become more important, and the cost efficiencies inherent in aggregate programs will appear even more competitive.

According to Robert J. Cooney, president of XL Insurance Company, Ltd., the next big step is something he calls "whole risk financing," which encompasses everything included in integrated risk programs today while adding an investment component that can be accessed to help pay for a catastrophic event.

In spite of all this opportunity for change, one thing seems certain. The theory on which integrated risk management is based remains fundamentally sound. No matter how the economy and customer needs change, this approach toward protecting against risk is broad enough—and flexible enough—to accommodate just about anything the customer needs. **RA**

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