INSURANCE RISK MANAGEMENT

Yet Another Concept for Security Analysts

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Commercial acceptance in Australia of the concept of risk management is a recent development, unlike the United States and Britain where the ideology has been popular for decades, especially in large companies. Whilst the term is well known in the insurance industry in Australia business managers have apparently only recently become aware of it.

The recent impact of rapidly rising premiums, in some cases doubling in a year, has however tended to hasten the more widespread acceptance of risk management (or loss prevention) disciplines developed over many years overseas. Reportedly many managers in 1975 had the new experience of making some tough commercial decisions about their insurance.

With less of the growth mentality adopted by the insurance industry in the nineteen fifties and sixties, as well as the large underwriting losses in the seventies, insurors have become more selective of the risks they will now underwrite. Suddenly it seems, insurance can no longer be bought like a commodity at the supermarket. For many even mundane risks there now lies ahead some hard bargaining with insurors and some tough commercial decisions to be made by managers.

The Development of Commercial Risk Management Organisations

The American Management Association in 1931 sponsored a section to deal specifically with non-financial risk management i.e. management of insurable risks. The section later set up regional conferences and seminars under the auspices of the A.M.A. In 1950 A.S.I.M. (The American Society of Insurance Management, Inc.) was formed in the State of Illinois and now has national coverage and a large membership. A.S.I.M. publishes a monthly journal and conducts a formal education programme. In the United Kingdom A.I.R.M.I.C. (The Association of Insurance and Risk Managers in Industry and Commerce) was formed and recently A.I.R.M.I.C. (N.Z.) was launched.

In 1974 A.S.I.M. was represented at a three-week seminar in Sydney and contributed papers. This was backed up by a thought-provoking paper in A.S.I.M.'s journal "Risk Management" entitled "Risk Management Australian Style" by Edward M. Wegman, which was widely acclaimed by company insurance managers as highlighting the generally unscientific approach of companies to insurance and the low status given to insurance matters.

It is difficult to trace the actual genesis of R.I.M.A.A. (The Risk & Insurance Management Association of Australia) which was successfully formed last year, although the influence cannot be overlooked of overseas-owned companies in Australia, guest speakers brought here by the Australian Insurance Institute and Willis, Faber, Johnson & Higgins, a local firm of brokers, which gave friendly advice.

"Risk Management" with its current back-drop of harder times for insurors and companies alike seems certain to quickly become something of an Australian vogue. Security Analysts be warned!

What Impact for Security Analysts?

As insurance is merely one of a host of variables weighed by the analyst when assessing a company it tends either to be overlooked or to be dealt with in summary fashion: "Are you adequately insured?" Answer: "yes". (Rarely is the analyst's considered conclusion about a company later set at naught because of an uninsured loss and this perhaps explains its relatively light weighting).

Should then the analyst bother to go beyond a single simple enquiry?

Some of the matters which an analyst could examine are:—

- What is the cost of insurance and its relationship to the total cost structure?
- What attempt is made to examine cost/benefits of various methods of insurance?
- What is the Company's claims history?
- What special risks does the company suffer?

These four questions quickly focus on the relative importance of insurance and what the company is doing in assessing its risks and measuring their associated costs. A little probing in this non-financial area of business risk may be a lead to ideas about management's general effectiveness and its ability to see risk and manage it.

Consider Henri Fayol's definition of management:

> "To manage is to forecast and plan, to organize, to command, to co-ordiante and to control. To foresee and provide means examining the future and drawing up the plan of action".

Risk management supplies some of the answers to "what if". For example, what if the company's only factory was lost by an event?

A quick analysis of Australian company histories may suggest that while a company is perhaps covered for material damage, it may be inadequately covered for consequential loss of profits as a result of an event, or alternatively the indemnity period for loss of profits may be too short.

Analysts can easily bring to mind total losses and their consequences for profits both immediately and longer term.

What about the loss of market share while the plant is being rebuilt?

On the other side of the coin there are companies which consistently over many years have a large margin between what they claim for accidents and what they pay out in premiums. The insured assets may be of a relatively non-hazardous kind which might properly be considered for partial or total self-insurance.

According to insurance writers an area often inadequately covered by companies is legal liability product insurance. What if the company's product causes damage such as poisoned crops, damaged plant, etc.?

How do companies in the U.S. for example, demonstrate to their members, security analysts and the public that they give due weight to insurance risk management? The following is an eloquent example published by a leading American company.

An example of a Corporate Policy of Risk Management

General Mills, Inc., a large U.S. company publishes its policy on insurance. It is done in such a way that it is perhaps, in itself a commentary on the failings of other companies in the field of insurance.

General Mills, Inc., Insurance Policy Statement

"The Company's general corporate insurance policy is:

1. To eliminate or reduce as far as practicable the conditions and practices which cause insurable losses.
2. When these risks cannot be eliminated or reduced to workable levels.
   (a) To purchase commercial insurance or operate formal self-insurance programs – in such amounts and in such areas as will provide assurance against catastrophe loss, and
   (b) To either insure or assume – whichever judgment indicates to be in the Company's best interest – those risks not considered individually to be of major importance to the operating or financial position of the Company.

But, in any event, to retain whatever portion of the risk for General Mills' account that premium reductions make economically attractive.

The Insurance Department's responsibility for implementing this policy includes:

1. For reducing risks:
   (a) Assisting the divisions and subsidiaries to design and operate fire control and loss prevention programs.
   (b) Reviewing new construction and facility alteration plans to assure risk control features and insurance acceptability.
2. For protecting against risks that cannot be eliminated:
   (a) Developing insurance coverage policy and programs, keeping them up to date, and assuring their effectiveness.
   (b) Administering insurance programs of domestic units of the Company and distributing premium costs as appropriate.
   (c) Controlling and reviewing foreign insurance programs to assure adequacy.
   (d) Negotiating and placing (or otherwise approving) all insurance contracts and bonds to assure conformity with established programs.
   (e) Approving insurance provisions in leases and other contracts prior to signature.
   (f) Reporting and adjusting all claims.
   (g) Maintaining such records as necessary to establish insurable value.
   (h) Developing and administering a corporate appraisal program, using commercial appraisals as appropriate.
   (i) Administering the operating the Company's captive insurance company, Gold Medal Insurance Co.

In carrying out these responsibilities, the Insurance Department will require the co-operation of people throughout the subsidiaries, divisions, and departments, for information and co-ordinated action. The development of this, in order to provide the full benefits of an effective risk management program to the units and corporation, is an important element of the Insurance Department's overall task. Quoted from "Risk Management & Insurance" by Williams & Heins.