



# Corporate Risk Management & Finance

Comparative Survey Results, Thoughts on Risk

A presentation to 2010 MIDWEST CFO FORUM  
by BARRY FRANKLIN

JUNE 16, 2010

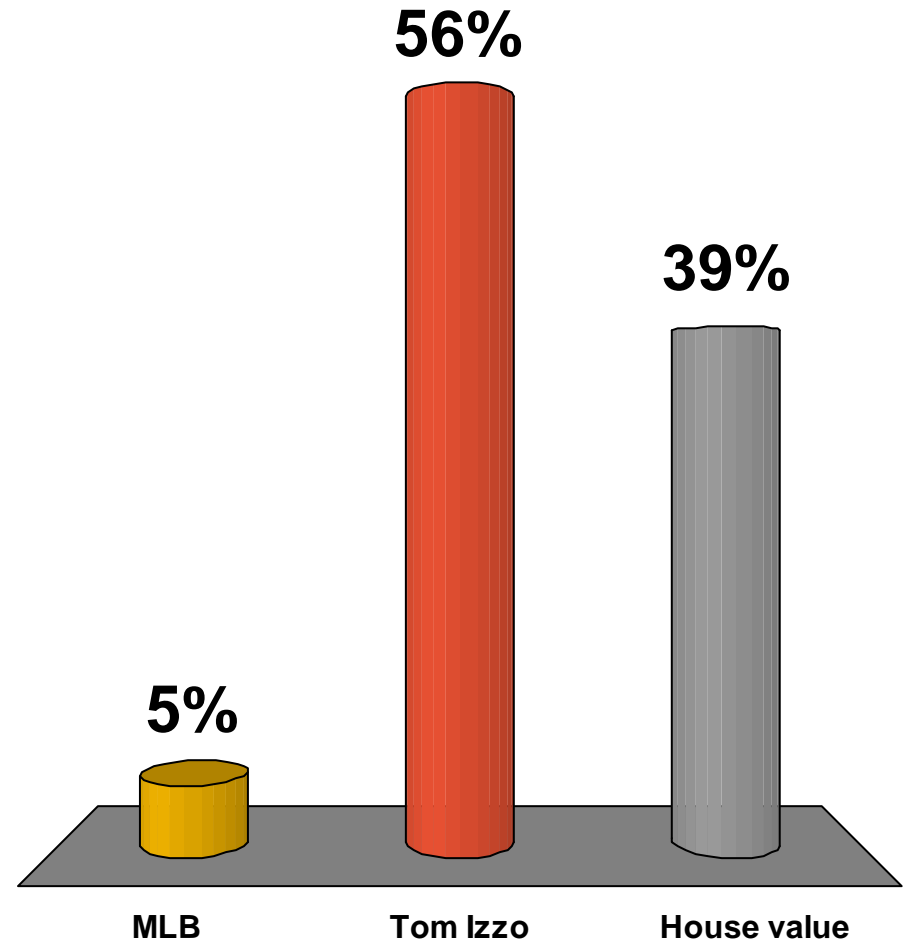
TOWERS WATSON 

# Agenda

- Risk management basics
- Survey results: national and audience
- Additional thoughts on risk

# What is the top indicator that the Michigan economy is recovering?

- A. Major League Baseball can finally afford to invest in instant replay
- B. Tom Izzo decides to stay at Michigan State
- C. Your house has returned to the value it had in 1980



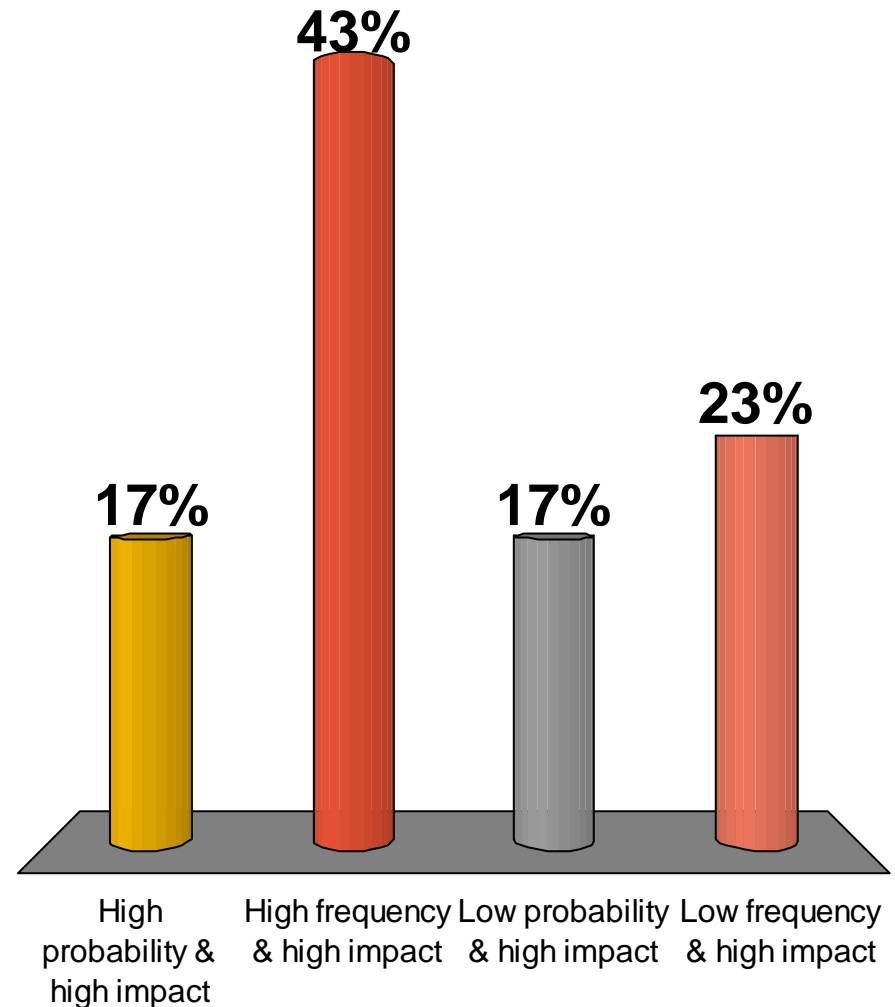
# Risk Management Basics

## Risk management basics - Where is your greatest risk?

- Not just an academic question
- Risk management resources are limited
- Knowing where your greatest risks are helps in focusing resources and attention where they are needed most

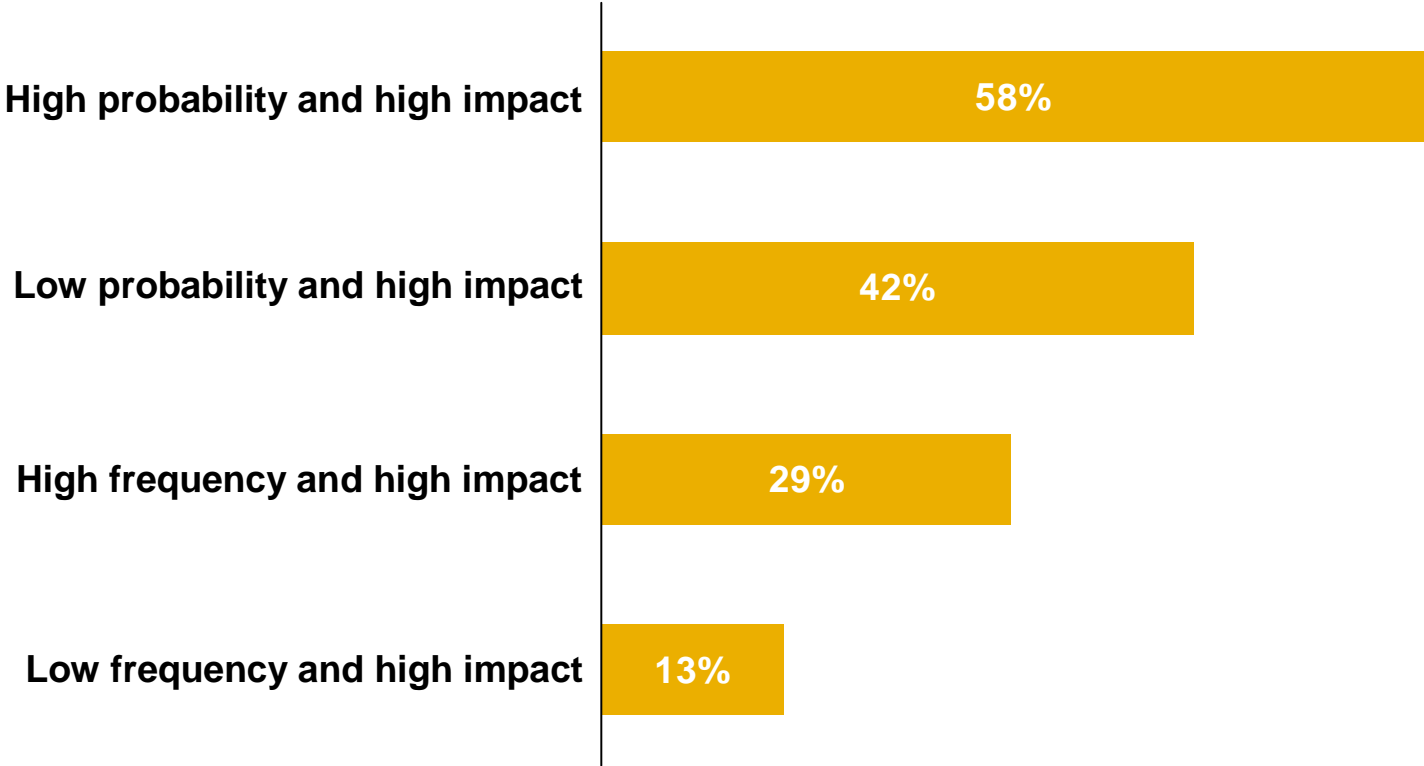
# Which of the following characterizes the HIGHEST level of risk?

- A. High probability and high impact
- B. High frequency and high impact
- C. Low Probability and high impact
- D. Low frequency and high impact



# National Results

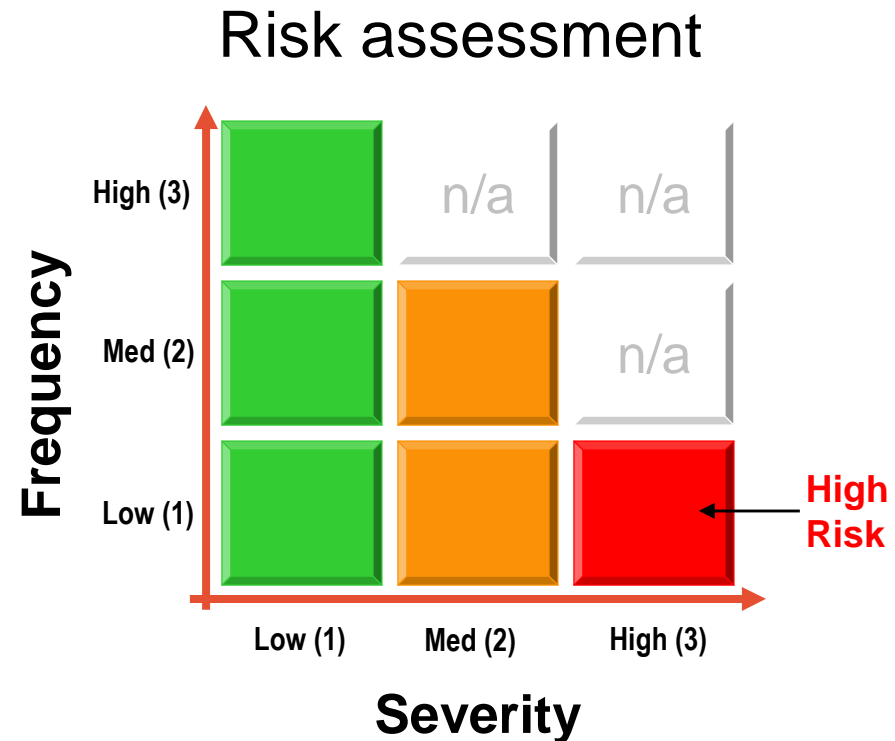
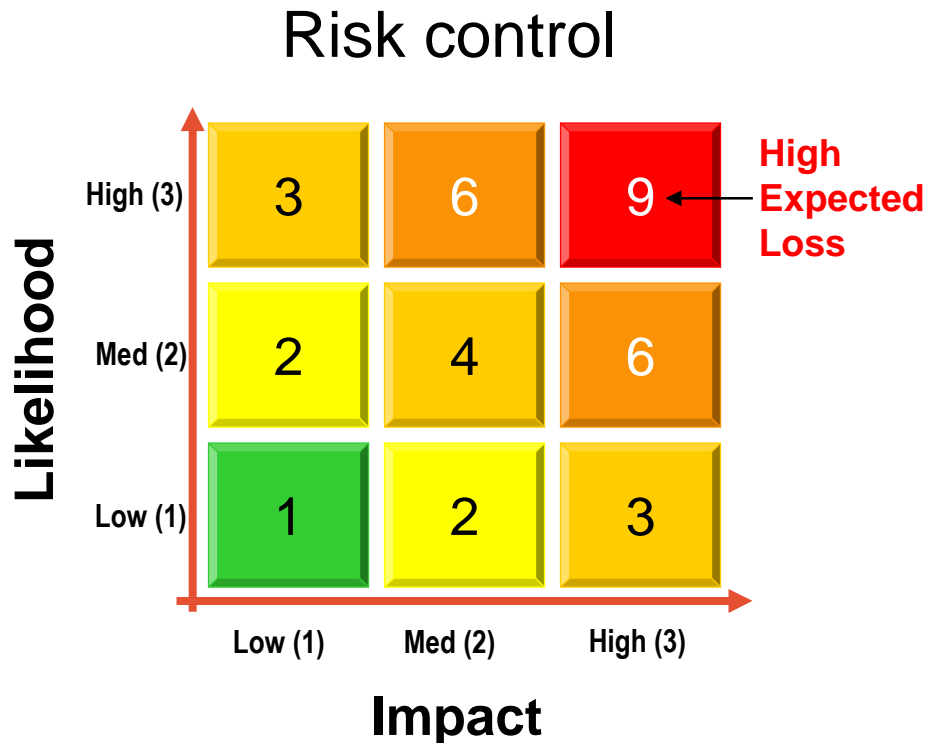
In your operational risk management framework, which of the following characterizes the highest level of risk?



Source: Towers Perrin CFO Survey

Base: n = 31

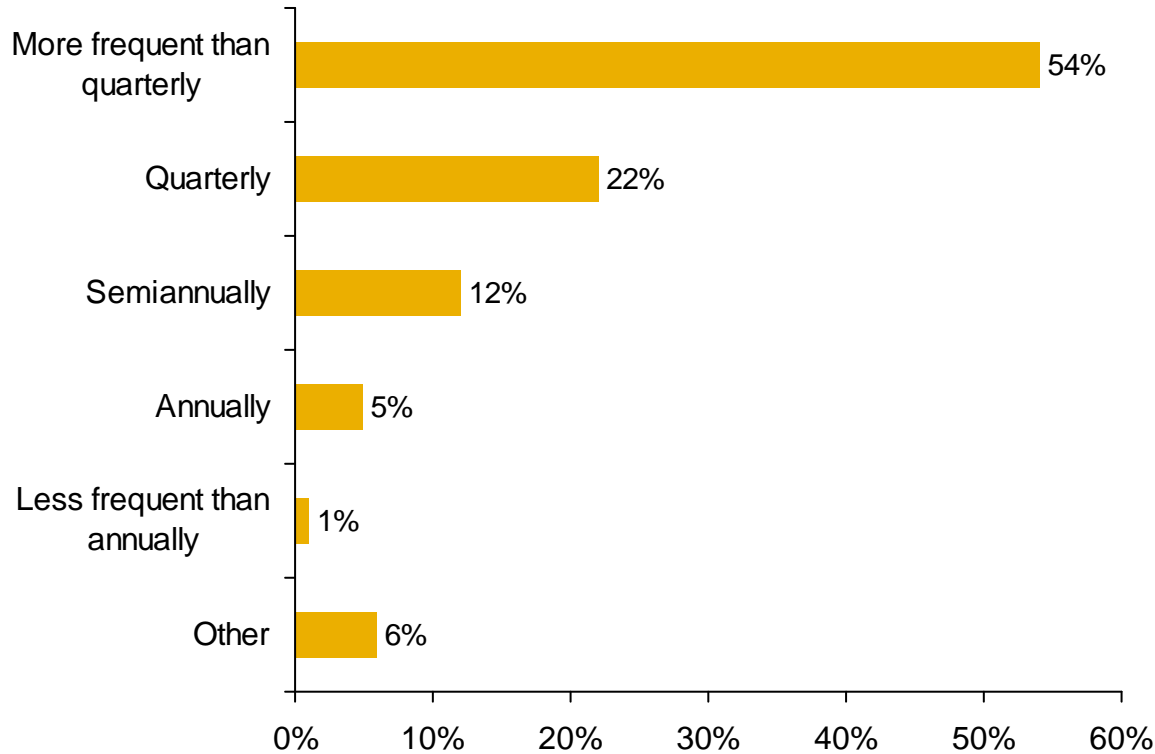
# Risk management basics - Where is your greatest risk?



# Survey of Risk and Finance Managers

# National Results

How often does your company meet with your insurance broker?

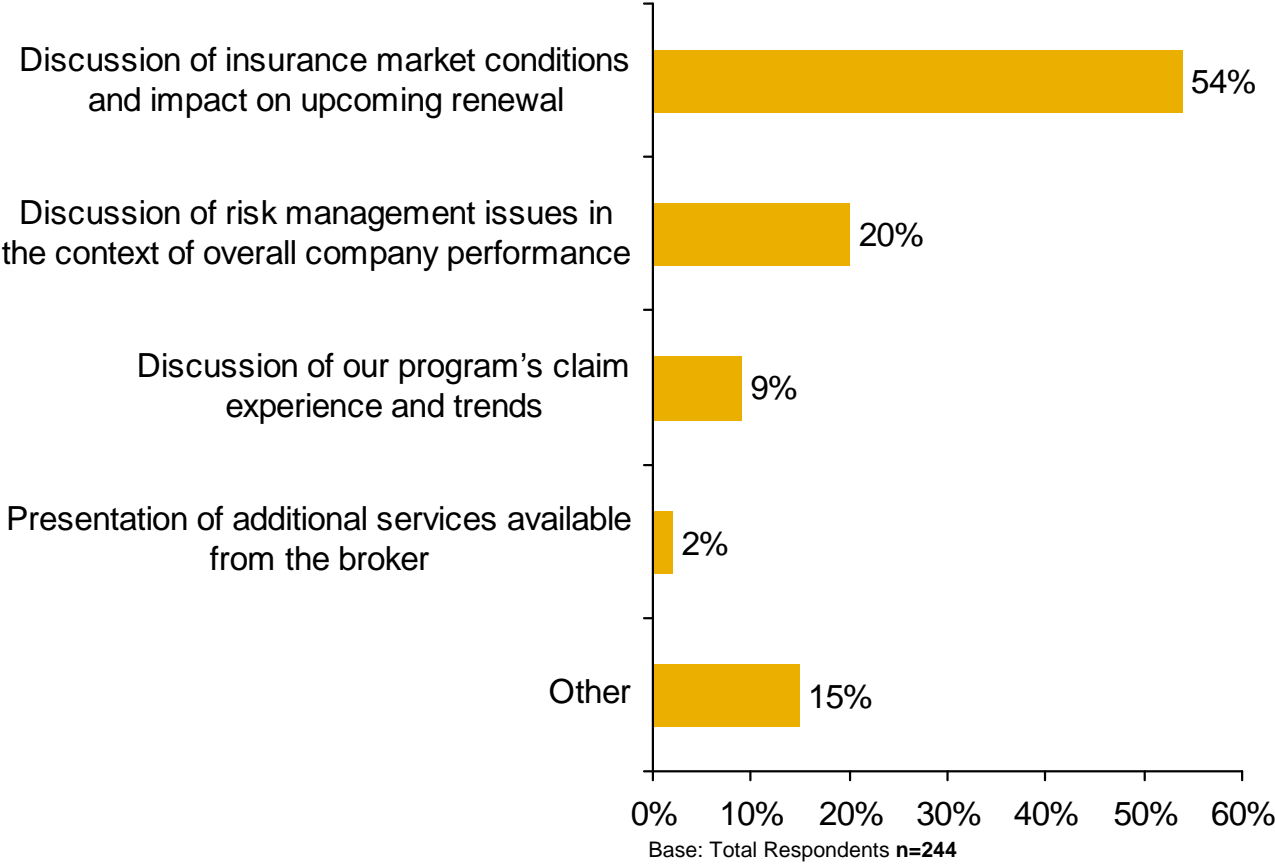


Base: Those giving a valid answer (percentages exclude don't know) n=239

Quarterly or more frequent meetings with the broker is the norm. At least twice yearly is the minimum.

# National Results

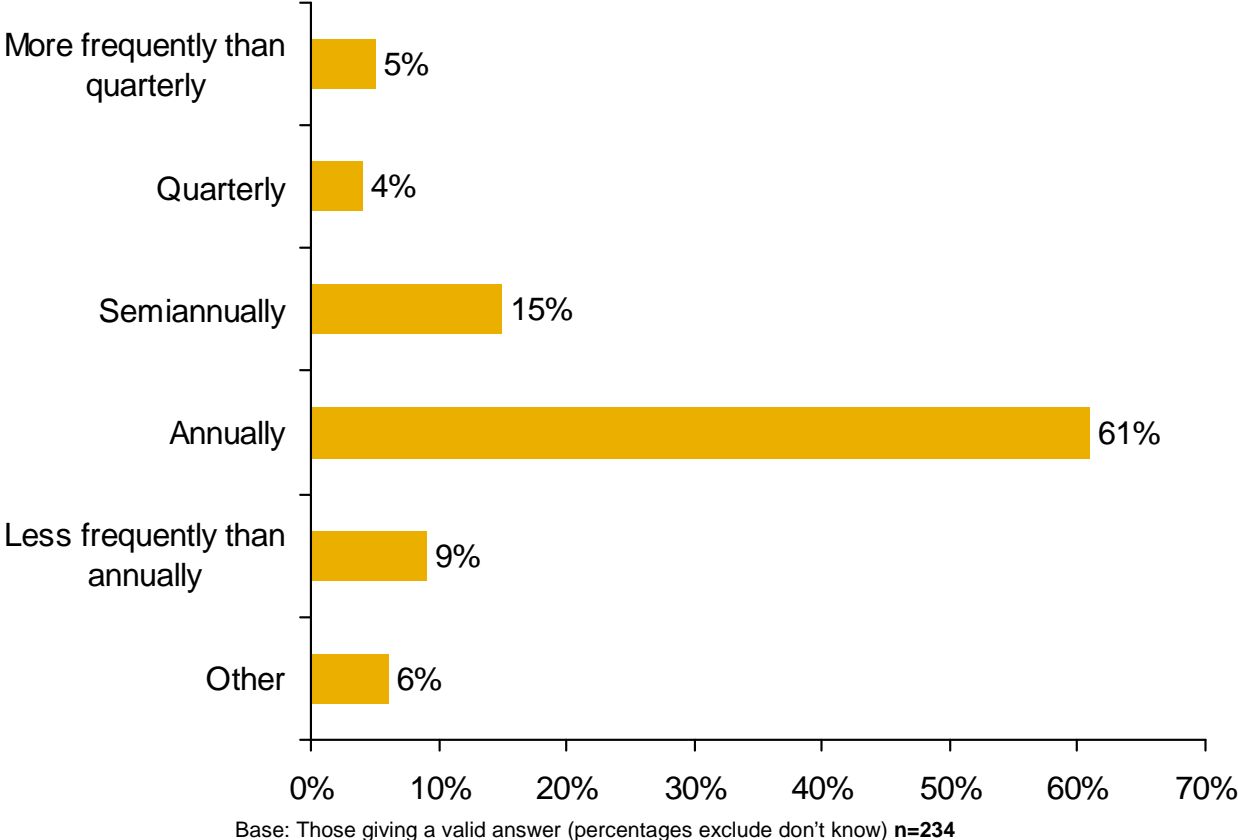
Which statement best describes typical meetings your company has with your insurance broker?



Broker meetings focus more on broker strengths (market placement) than company priorities (managing retained loss costs)

# National Results

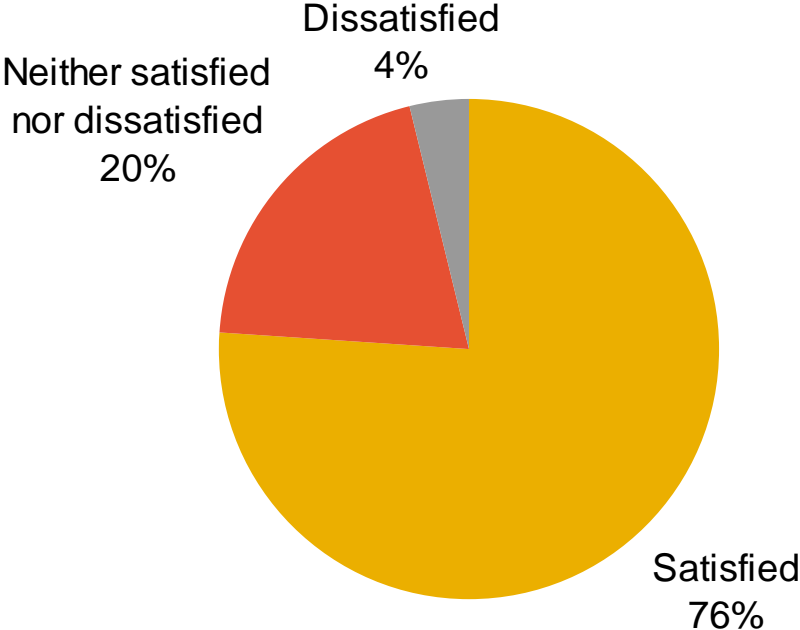
How often does your broker critically review your risk retention and financing costs?



Brokers seem to be doing well at regularly updating loss forecasts and cost projections, with over 80% reviewing at least annually

# National Results

How satisfied are you with the analytics your broker provides?

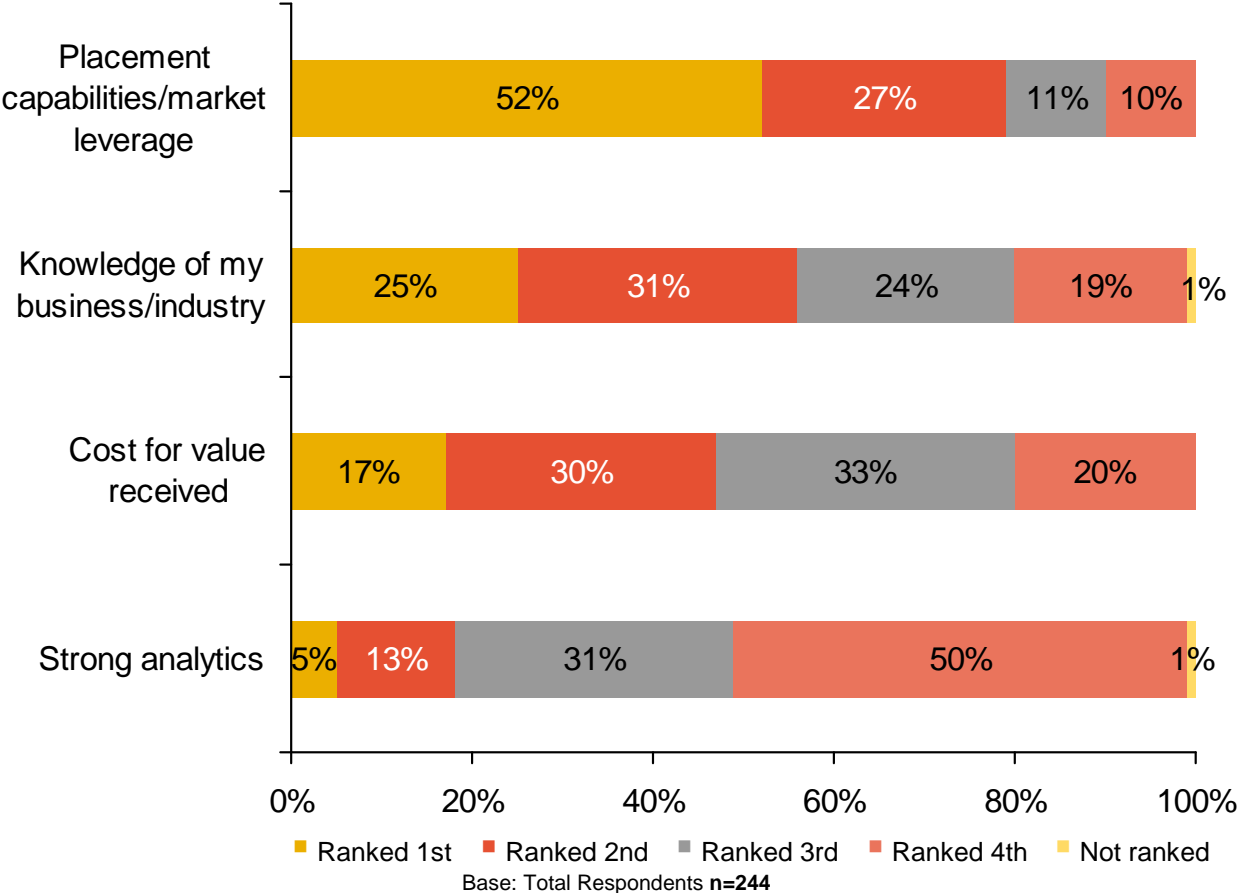


Base: Those giving a valid answer (percentages exclude don't know and not applicable) n=223

Companies express a high degree of satisfaction with the analytics provided by their insurance broker

# National Results

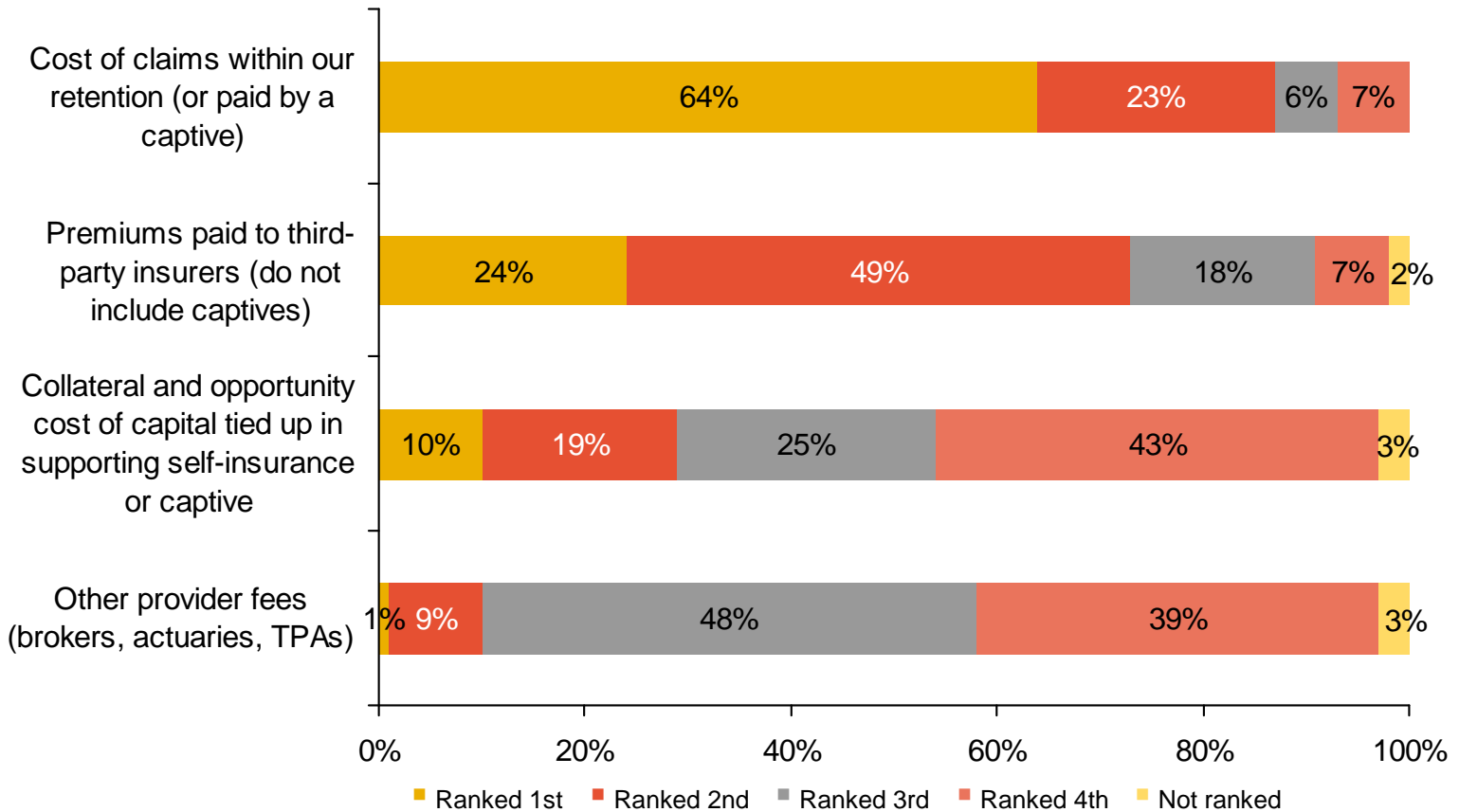
Which aspects of your broker's service are most important to you?



Because they do not expect or demand strong analytics from brokers, placement capabilities and industry knowledge are key to most customers

# National Results

Which aspects of the "total cost of risk" are most important to you?



Base: Total Respondents n=244

Retained claims as the most significant component of TCOR. The question becomes: "Where do companies turn for help in managing this critical aspect of their overall risk financing program – are brokers and actuaries equipped to fill this need?"

## Summary of survey findings

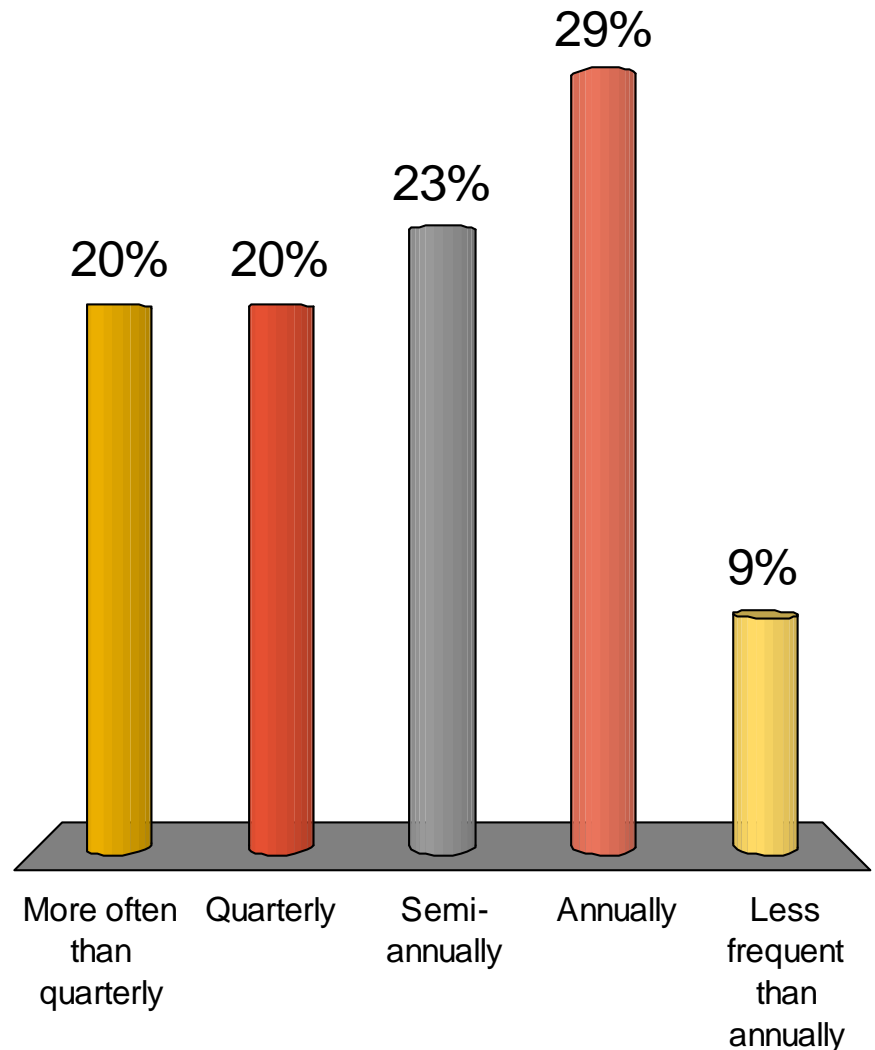
- Lots of engagement between insurance brokers and risk managers
- Primary focus on insurance market conditions and expectations
- Retentions and limits reviewed regularly
- High level of satisfaction with broker analytics
- Broker's primary value is in placement capabilities and market leverage
- Retained losses are the most important aspect of TCOR

# Now it's your turn – audience survey

# How often do senior Finance/Treasury staff meet with your Risk Manager or the equivalent?

- A. More often than quarterly
- B. Quarterly
- C. Semi-annually
- D. Annually
- E. Less frequent than annually

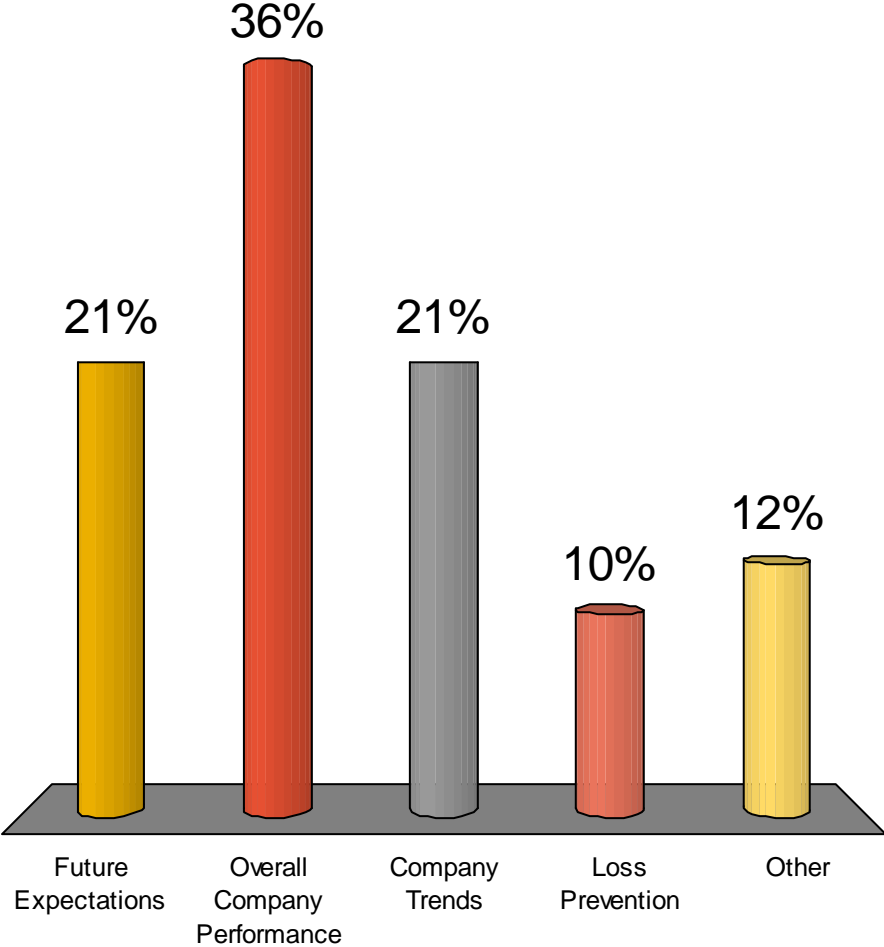
Regular meetings with Finance/Treasury are best practices for Risk Managers.



# What is the focus of interactions between Finance/Treasury and Risk Management (or the equivalent)?

- A. Expectations regarding future insurance premiums
- B. Discussion of risk management issues in the context of overall company performance
- C. Discussion of your company's claim experience and trends
- D. Safety & loss prevention
- E. Other

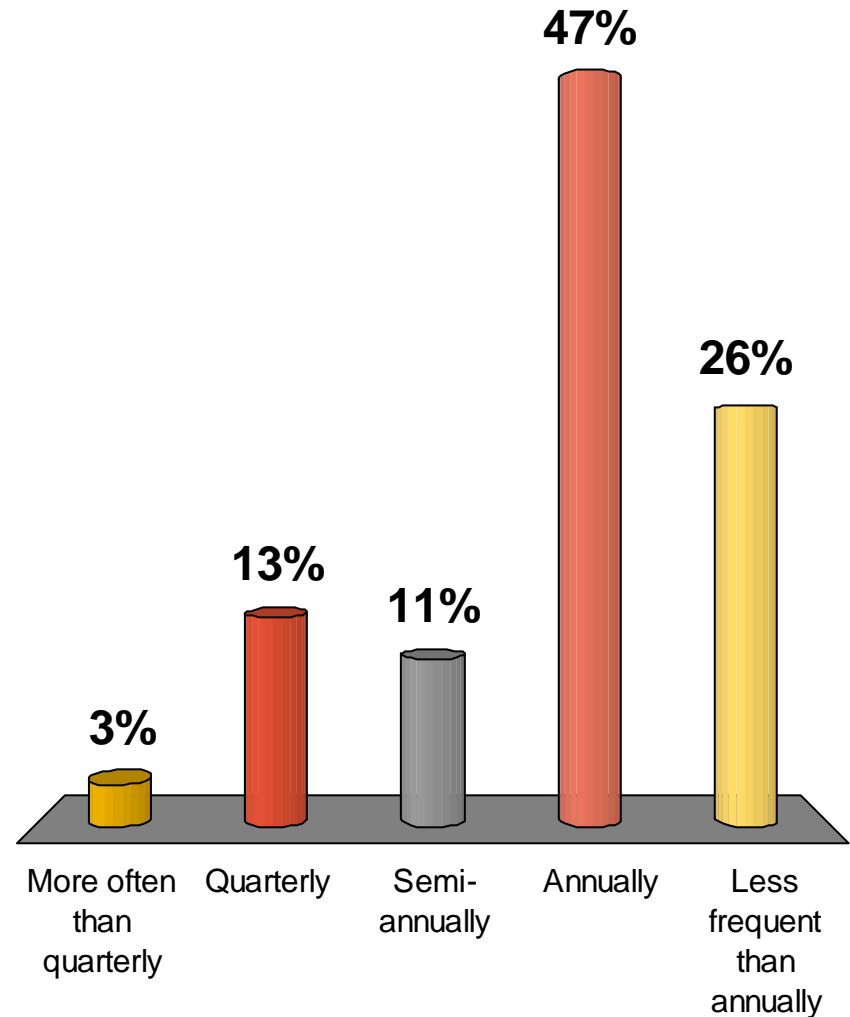
Risk managers should cover market trends with brokers and focus internal conversations on company performance.



# How often do you critically review your risk retention levels and financing costs with your Risk Manager (or equivalent)?

- A. More often than quarterly
- B. Quarterly
- C. Semi-annually
- D. Annually
- E. Less frequent than annually

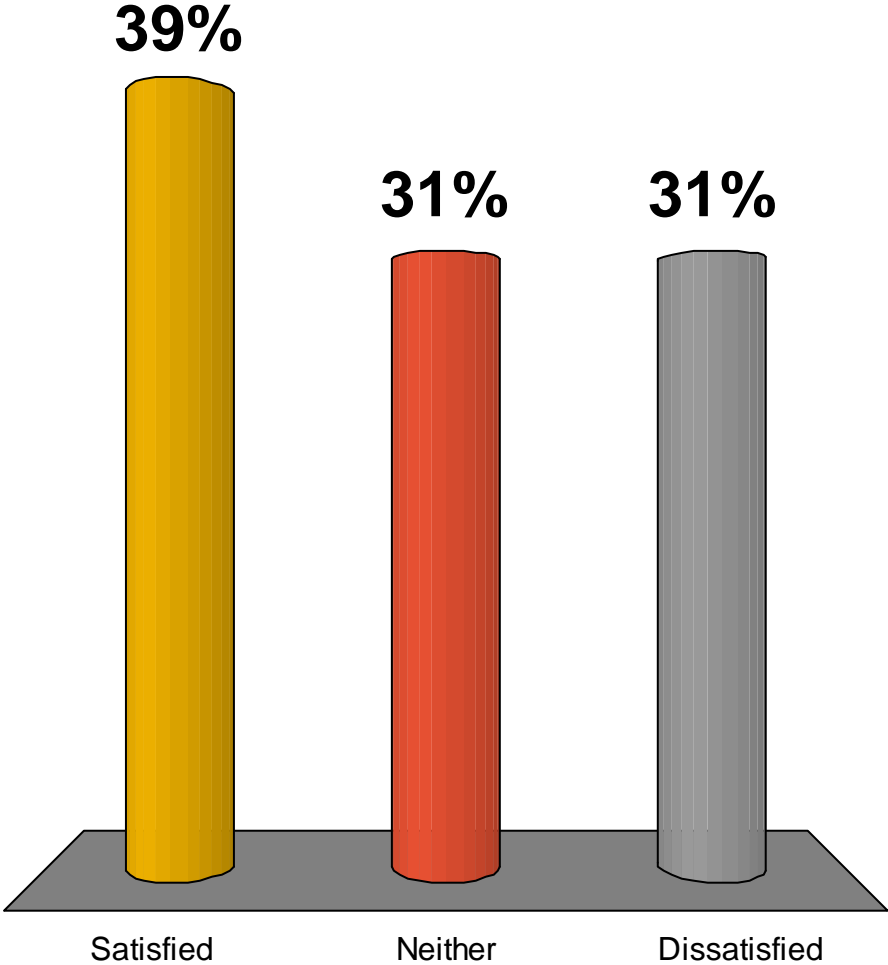
Risk Management and Finance should work closely together to determine the level of risk retained versus insured/transferred



# How satisfied are you with the analytics provided or communicated by your Risk Manager (or equivalent)?

- A. Satisfied
- B. Neither satisfied or dissatisfied
- C. Dissatisfied

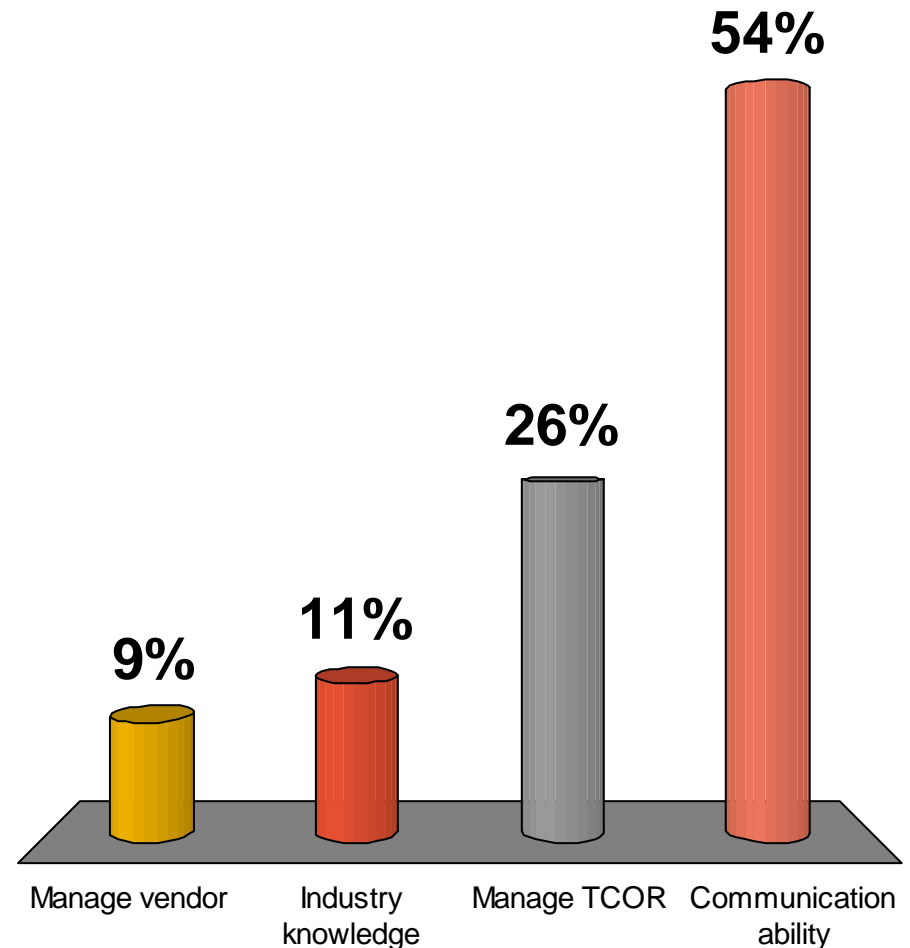
Risk management is increasingly becoming a discipline defined by metrics, measurement and analysis



# Which of the following attributes of your company's risk manager (or equivalent) are most important to you?

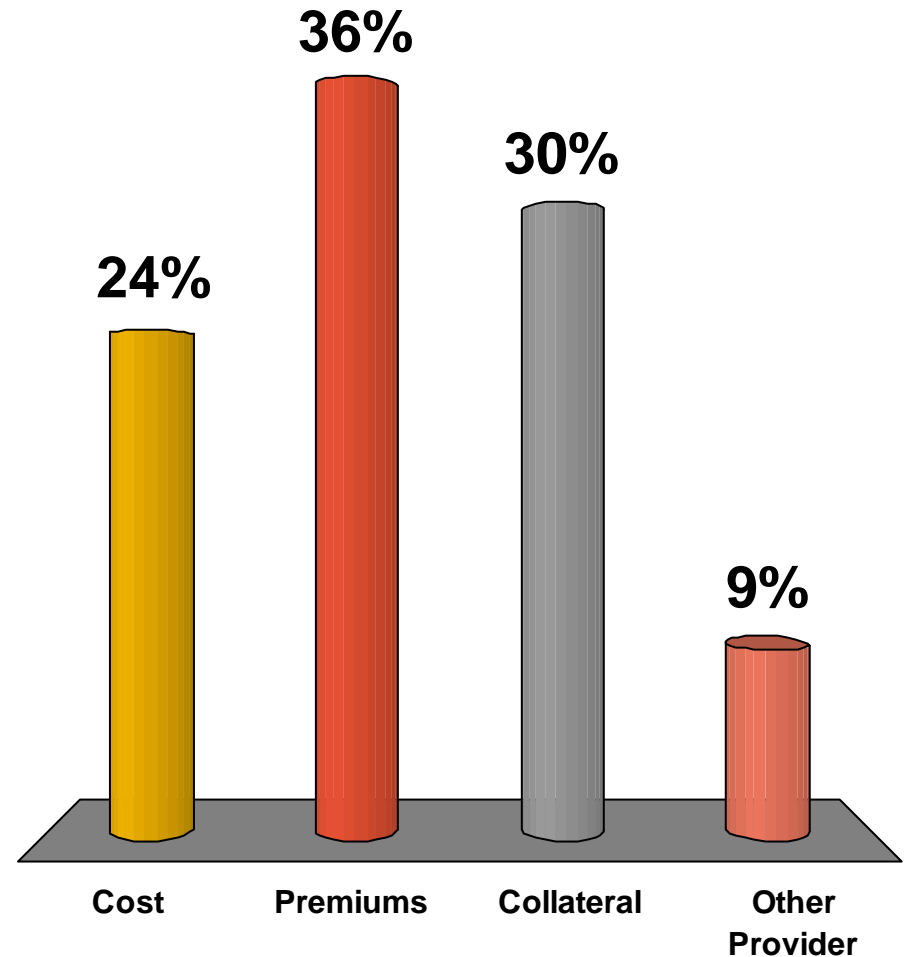
- A. Ability to manage vendor relationships (broker, TPA, etc.)
- B. Knowledge of your industry
- C. Ability to manage total cost of risk (TCOR) within budget
- D. Ability to communicate risk issues within the organization using practical metrics and measures

Many risk managers are viewed in a more “qualitative” context (whether by corporate tradition or personal choice).



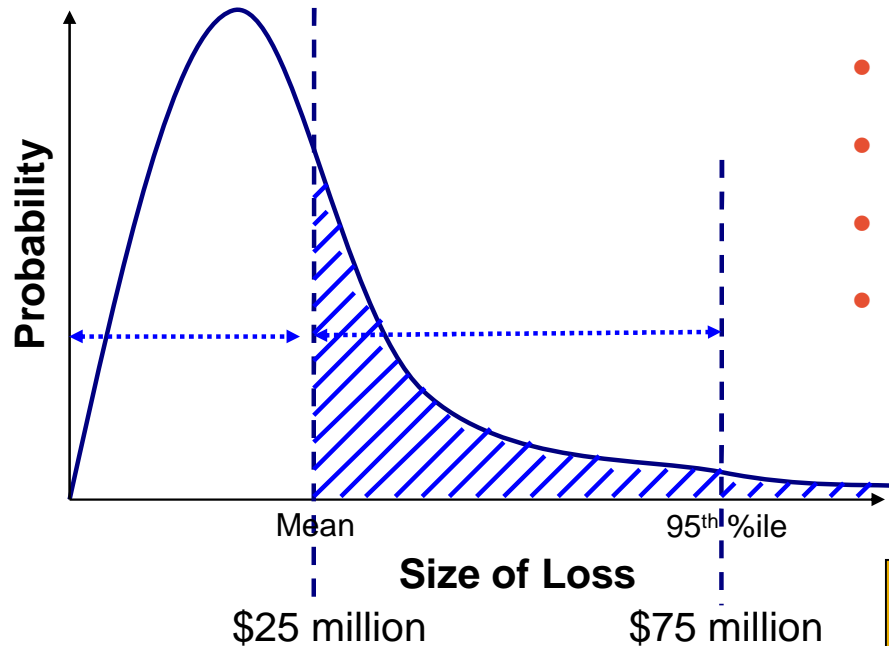
# Which aspects of “total cost of risk” are most important to you?

- A. Cost of claims within our retention (or paid by captive)
- B. Premiums paid to third party insurers (do not include captives)
- C. Collateral and opportunity cost of capital tied up in supporting self-insurance or captive
- D. Other provider fees (brokers, actuaries, TPA's)



# Additional Thoughts on Risk

# The “Cost” of Risk



- Expected loss = \$25 million
- 95<sup>th</sup> %ile loss = \$75 million
- Unexpected loss = \$50 million
- Target return on capital = 12.0%
- Risk- free rate = 2.0%

**Opportunity cost of capital =  
\$50 million \* (12.0% - 2.0%) = \$5.0 million**

## How much are you saving, really?

Insurer View	\$0 per claim retention	\$250,000 per claim retention	\$500,000 per claim retention
Expected Loss	\$5.8 million	\$2.7 million	\$2.2 million
95 <sup>th</sup> Percentile Loss	\$13.3 million	\$10.0 million	\$9.4 million
Unexpected Loss <sub>95</sub>	\$7.5 million	\$7.3 million	\$7.2 million
Company View	\$0 per claim retention	\$250,000 per claim retention	\$500,000 per claim retention
Expected Loss	\$0	\$3.1 million	\$3.6 million
95 <sup>th</sup> Percentile Loss	\$0	\$4.2 million	\$5.3 million
Unexpected Loss <sub>95</sub>	\$0	\$1.1 million	\$1.7 million

# Savings Comparison

	\$250,000 per claim retention	\$500,000 per claim retention	\$ Savings	% Savings
<b>Premium</b>	<b>\$ 3,924,612</b>	<b>\$ 3,252,242</b>	<b>\$ 672,370</b>	<b>17.1%</b>
Retained Loss (EL)	3,061,342	3,594,406	(533,064)	(17.4%)
TPA Fees	578,056	578,056	0	0.0%
Broker fees	235,477	195,135	40,342	17.1%
<b>TCOR</b>	<b>\$ 7,799,487</b>	<b>\$ 7,619,839</b>	<b>\$ 179,648</b>	<b>2.3%</b>
Capital Cost	129,766	202,450	(72,685)	(56.0%)
<b>TCORF</b>	<b>\$ 7,929,252</b>	<b>\$ 7,822,289</b>	<b>\$ 106,963</b>	<b>1.3%</b>

# Recent Conditions and Impact on Insurance Costs

## Recent Economy Trend/Cycle

- “Soft insurance prices”
- Staff reductions/layoffs
- Lower sales/production
- Reduced yields on bond portfolios, large real estate write-downs

## Impact on Risk Mgmt/Finance

- Lower premiums, broker fees
- Lower payroll, reduced WC premiums, lower claim frequency, increased incentive for fraud
- Lower inventory, lower Property and Product Liability exposure, reduced premiums
- Insurance company profits hit, balance sheets weaker, but still excess capital

Conventional wisdom is that the insurance pricing cycle is nearing the “bottom”.

# What to Expect as the Economy Recovers

## Future Economy Trend/Cycle

- Increasing employment
- Higher sales/production
- Increased interest rates
- Increased inflation
- Insurance prices firm

## Impact on Insurance Costs

- Increased payroll, higher WC premiums, higher claim frequency,
- Growing inventory, increased Property and Product Liability exposure, higher premiums
- Losses on insurer bond portfolios, reduced statutory capital & surplus, higher expected future yields
- Losses and fixed costs increase, pushing premiums up
- Higher rates, tighter underwriting

Higher rates and increased exposure can drive significant premium increases

# What Companies Can Do as the Market “Hardens”

## Insurance Strategies

- Optimize retention levels
- Leverage captive insurers
- Lock in longer term deals now

## Other Strategies

- Consolidate TPA’s
- Focus on safety and loss prevention
- Align incentives and calibrate cost allocations methods accordingly
- Understand risk appetite

Focus on the aspects of TCOR within your control

# Questions?

# Contact Details

- Barry Franklin, FCAS, MAAA, CERA
  - Director, Corporate Risk Consulting
  - 312 201 4689
  - [barry.franklin@towerswatson.com](mailto:barry.franklin@towerswatson.com)
  
- Phil Ullom
  - Managing Consultant, Michigan offices
  - 248 936 7500
  - [philip.ullom@towerswatson.com](mailto:philip.ullom@towerswatson.com)