

Fresh thinking on risk:



FastFastForward

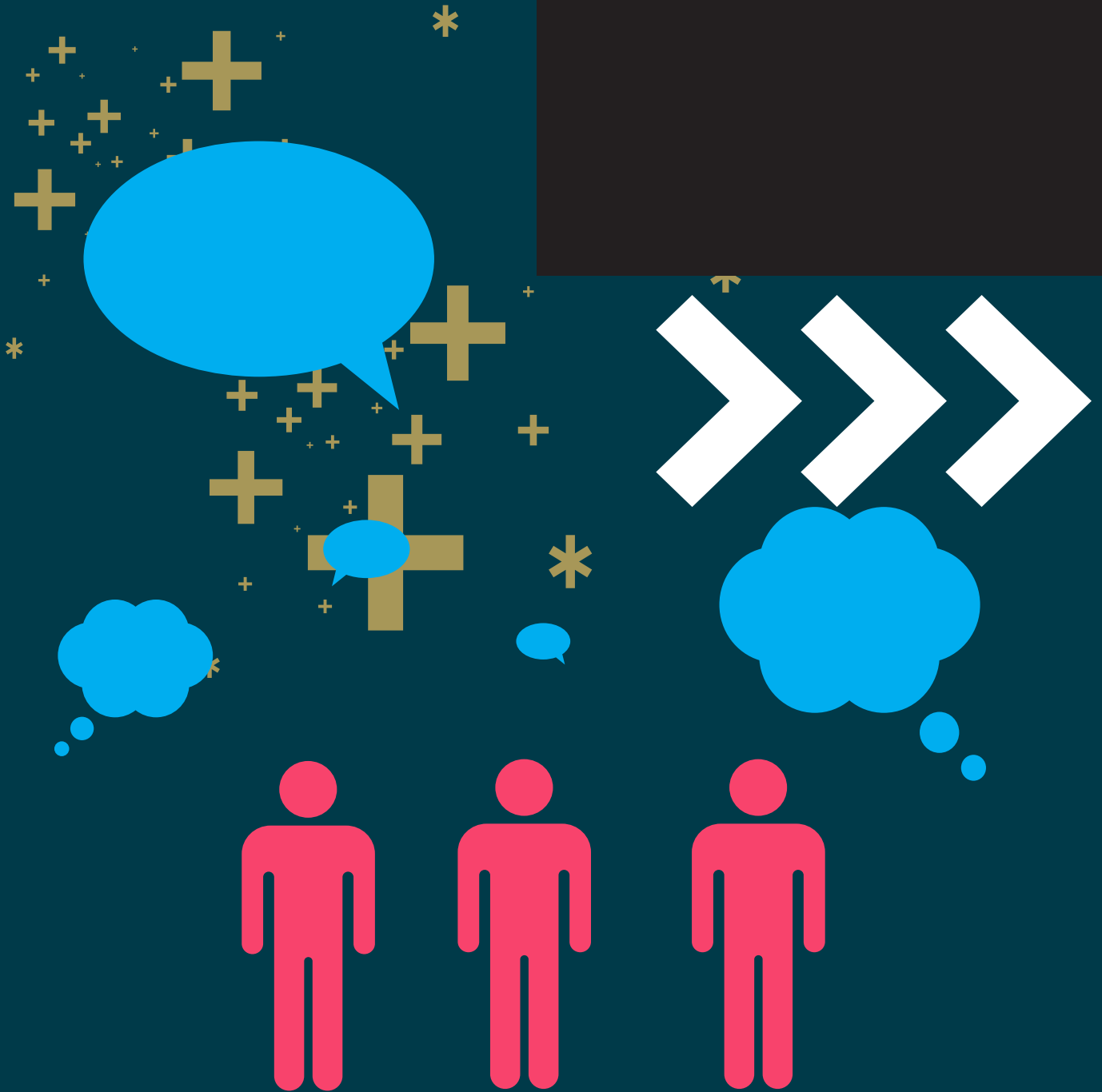
Thank you!

You've just accessed a PDF on Fast Fast Forward, XL Group's online platform for sharing news, commentary, and ideas about business challenges. Here, we share thoughts about persistent risks and emerging ones; new ideas; innovations; and risk management strategies that help keep businesses moving forward. We're a (re)insurer and risk is our business.



We invite you to explore more:
xlgroup.com/FastFastForward

Enjoy!



Assessing the
value of risk

Assessing the value of risk

Annual reports will invariably include comment on a company's risk management programme but for investors and the board alike, often the time when such a programme is truly appreciated is in the event of a claim- the crucial interface between underwriter and insured when the underlying value of an insurance programme really stands out.

As intangible as policies may appear to be, the client rightly expects a valid claim incident to trigger a pay-out. Indeed, once purchased, many chief executives only realise the value of their policy once they have to claim, and it's at that point they hope it is going to respond, fast, minimising damage to the business.

Underwriters, brokers and risk managers themselves will hardly need reminding of the cost of claims, of course, with last year presenting a number of major events estimated to cost the (re)insurance market in the region of \$34bn. Among the major property claims of 2014 were the storms that struck the northeast US at the beginning of year, which accounted for \$1.7bn of insured losses, and a \$2.9bn industry hit from US hailstorms in May.¹

Despite the high profile nature of many of these events, it's still debatable whether many large-scale corporates, faced with the renewal of their insurance programme, still appreciate the value of the product they are purchasing and instead remain overly focused on price.

According to a recent article in *The Harvard Business Review*, a big part of the problem lies with companies themselves, which remain trapped in an outdated approach to value creation that has emerged over the past few decades. Some continue to view value creation narrowly, optimising short-term financial performance in a bubble while missing the most important customer needs and ignoring the broader influences that determine their longer-term success.²

Foremost amongst these needs is the necessity for a properly structured insurance programme which won't fail when put to test at the moment of a claim. It's all about matching the proposition to the buyer by providing specialisms. In this way a multitude of issues can be wrapped up in an insurance product -- geographical exposure, complex supply-chain issues, technical and operational challenges, financing and various other intangible elements.

The virtuous circle is complete when a chief executive is presented with a clear solution, despite the complexity of the work invested in it.

Today then there is more pressure than ever on insurance to perform. Natural catastrophes aside, incidents of data breaches and cybercrime (of which several US department stores were victims in early 2014), increased product liability, political risks especially in emerging markets, acts of terrorism, kidnapping and ransom incidents are not only increasing but growing more complicated.

As companies push into new frontiers in Europe, US, Latin America and other markets, some risks aren't even known. As Steve Gay, then director of life savings and protection at the Association of British Insurers, told a summit of corporate advisers late last year, the forces of economics and technology are pushing insurers to change their ways. "[They] are demanding that we become much more agile in the way we think about the way our market operates," he said.

Quantifying value

As insurers are becoming more agile, so too risk managers are becoming more savvy in their research. Nowadays it is becoming easier to measure the value of a global programme, especially in relation to its claims service.

In its 2014 Benchmarking Report, for example, the Federation of European Risk Management found that data is increasingly being used in a much more fluid and dynamic way by risk managers who are gathering information and using it more widely than they were before, which is impacting on their assessment of the value of the claims experience. According to the report, whereas traditionally IT platforms were used to collect information on claims and insured values, today, risk managers are linking that claims experience and cost of claims to risk management efforts and so are able to generate greater insight into the impact of intervention and control on the business.³

The role of insurance is also being redefined. A policy is no longer a mere document gathering dust on a shelf until it's suddenly needed.

Ideally, it's an enabling tool that enshrines specific undertakings that can give a chief executive the peace of mind and freedom to focus on growing the company with the confidence that it's protected from multiple risks.

This statement holds true when we think about the floods in Thailand in the last half of 2011 that, as well as causing tragic serious loss of life, knocked out the local factories of some of Europe's biggest companies. According to the World Bank, total economic losses amounted to US\$45.7bn. And most of that fell on the private sector.

¹ 'Total insured losses hit \$34bn in 2014', *The Insurance Insider* 17 December 2014, www.insuranceinsider.com

² 'Creating Shared Value', *Harvard Business Review*, January 2015

³ 'FERMA Benchmarking Report 2014: A UK Perspective' Federation of European Risk Management

Although standard policies covered these flood-stricken companies against physical damage, many of these losses could have been averted by a closer relationship. Seeking good adviser support before the plants were built could have warned against concentrating so much economic muscle in river basins that are historically vulnerable to natural catastrophes.

The Thai Floods also demonstrated that there are still too many instances where there is a failure to appreciate the coverage that has been purchased. There were a number of issues that meant recovery of losses under contingent business interruption (CBI) extensions were limited. Some of the CBI extensions of the Thai policies were written on the basis of limited perils – namely, fire lightning and explosion – and there was no cover for flood. Even though the main property damage/ business interruption wordings were on an all risks basis, the CBI extensions were limited perils. As a result, a number of insureds had limited or indeed no CBI cover, resulting in substantial uninsured losses.⁴

The holistic programme

Although a programme's ability to deliver on the claims front is therefore crucial to its value, there are a host of other pertinent factors which should be considered when purchasing insurance, according to Airmic - the UK's risk managers' association. In the first instance, it suggests, the overall reputation of the insurance company is important, both in general and in relation to a company's specific business sector. Overall, risk managers will need to evaluate several factors, including the following:

- Financial strength of the insurance company
- Area of specialism and relevance to your business
- Premium charged and cost of any extensions
- Scope of cover and nature of any exclusions
- Level of excess or deductible available / imposed
- Reputation for the handling and payment of claims
- Level of support and range of advice available
- Nature and extent of the working relationships offered⁵

Thus an insurer has a much bigger role to play than merely writing a policy as a backstop against various forms of unforeseen events. Rather, it should fulfil a number of functions – risk mitigation and trusted confidant. In short, a savvy provider who understands a client's business inside and out. It's important that an insurer knows what keeps a chief executive awake at nights -- that's how the (re) insurance market can take key risks off the balance sheet. A policy should not be just a commodity purchase.

⁴ 'The Thai 2011 Floods: Contingent Business Interruption Insights', Echelon

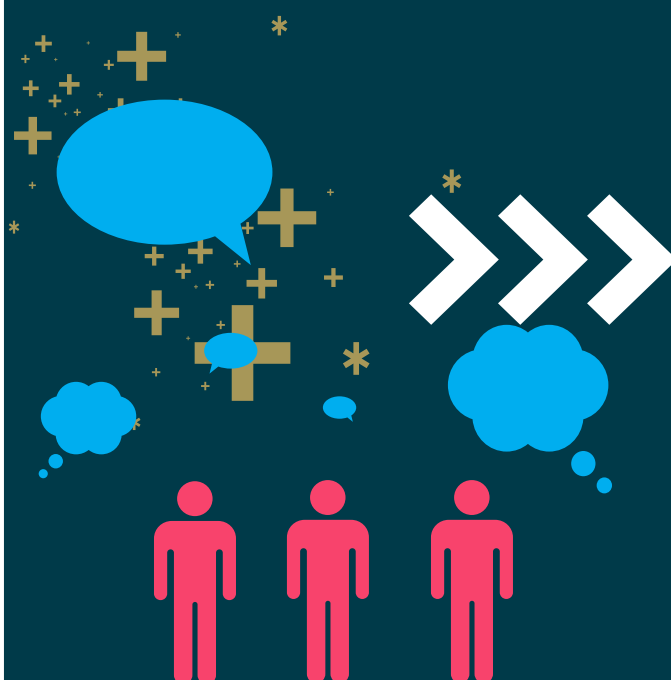
⁵ 'Buying Insurance For Your Business', Association of Insurance and Risk Management in Industry and Commerce, <http://www.airmic.com/system/files/Airmic-insurance-buyers-guide.pdf>

xlgroup.com

This general product description is informational only. It is neither an offer to sell nor a solicitation to purchase any particular insurance product. Coverages may not be available in all jurisdictions. Products subject to legal and underwriting requirements. Specific product availability varies by global jurisdiction.

 is a trademark of XL Group plc companies. XL Group is the global brand used by XL Group plc's insurance and reinsurance subsidiaries.

XL Group
Insurance



MAKE YOUR WORLD GO



MAKE YOUR WORLD GO are trademarks of XL Group plc companies