Risk Management

How To Protect Your Company

Cloud, Minturn & Associates

Risk Management Advisors
Registered Investment Advisor
Human Resource Administrators

3858 West Carson Street, Suite 204
Torrance, CA 90503-6705
Tel: (310) 316-3662
Fax: (310) 755-6080
Email: info@cloudminturn.com
www.CloudMinturn.com

Important Notice

For further information, please contact:

Cloud, Minturn & Associates

3858 W. Carson St., Suite 204

Torrance CA, 90503

Tel: (310) 316-3662

Fax: (310) 755-6080

Email: info@cloudminturn.com

www.cloudminturn.com

RISK MANAGEMENT

Identifying and Treating Loss Exposures

The main purpose of risk management is to identify those areas in the operations of a business which, if ignored, will leave the entity exposed to serious financial loss. There are four (4) basic steps to risk management:

1. **Identifying** the problem,
2. **Selecting** appropriate treatment,
3. **Evaluating** the treatment, and
4. **Monitoring** the selected program.

These responsibilities generally fall upon the shoulders of the owner and/or manager of a firm, as most companies do not have the resources to employ their own Risk Manager.

Let's detail the four (4) processes outlined above. In doing so we will begin to see how, by combining loss control measures, insurance, risk transfers and planned retention, a company can successfully meet its risk management objectives.

Step #1: Identifying the Problem

Identification is the first step in any Risk Management Program. If an exposure is not recognized, then it may be unconsciously retained. This is particularly important in the area of Professional Liability which may involve bodily injury and even wrongful death suits alleging negligence on the part of the agent in failing to properly advise clients regarding the sometimes inherent dangers of travel.

Identifying all loss exposures should be an ongoing process, since conditions affecting the business environment are ever changing. For example, if a business opportunity presented itself tomorrow, a company's situation could quickly change.

In identifying current and any potential new exposures, a manager should rely on the advice of as many professionals as possible, such as attorneys, accountants, insurance brokers and trade associations.

Step #2: Selecting Appropriate Treatment

This aspect of risk management involves those four (4) treatments mentioned earlier: Loss Control, Insurance Protection, Risk Transfers, and Planned Retention. Most companies use a combination of all four (4) treatments in their risk management programs.

Loss Control - These are measures which can be taken to reduce the frequency and severity of losses.

There are a number of loss control methods available to companies. Some of these measures include: screening and selection of suppliers, wording of brochures, employee handbook, proper usage of HR forms, injury & illness prevention program, offering of insurance, client refunds, written contracts and handling of potential liability claims.

Insurance Protection - Among the Liability-related insurance products available to companies:

Professional Liability Insurance - Many different types exist, however, experts often recommend that a Professional Liability product offer separate and distinct coverages for Bodily Injury and Property Damage, (including specific mention of "non-owned" and "hired" automobile coverage), Errors and Omissions, and Personal Injury. The policy should clearly state that all of the operations of the insured company are covered, as opposed to specifying just a portion, or excluding certain operations. This comprehensive approach can help to eliminate potential gaps in coverage.

Workers Compensation & Employer's Liability - Available through private insurers or state funds, these products compensate employees for job related accidents or illness and protect employers against claims for which they are held legally liable.

Commercial Auto Liability Coverage - For owned and leased/hired vehicles.

Umbrella Liability Coverage - Provides excess limits over existing liability coverages, and primary coverage for some areas not covered by underlying insurance.

Employment Practices Liability - A form of liability insurance covering wrongful acts arising from the employment process. The most frequent types of claims alleged under such policies include: wrongful termination, discrimination, and sexual harassment.

Fiduciary Liability - The responsibility on trustees, employers, fiduciaries, professional administrators, and the plan itself with respect to errors and omissions in the administration of employee benefit programs as imposed by the Employee Retirement Income Security Act (ERISA).

Cyber Liability - Addresses the first and third party risk associated with e-business, the Internet, networks and informational assets. Cyber Liability Insurance coverage offers protection for exposures arising out of Internet communications. The risk category includes privacy issues, the infringement of intellectual property, virus transmission, or any other serious trouble that may be passed from first to third parties via the Web.

Directors & Officers Liability Insurance - Protects against claims from stockholders, partners, and employees, competitors, creditors & regulatory agencies.

Risk Transfers - When a company transfers an exposure, or the financial responsibility associated with that exposure, they are said to be "transferring risk." That is, the consequences of the exposure are passed to another, and/or the activity related to or causing the exposure is transferred to another.

Insurance is a perfect example of the first type of risk transfer. With insurance, the financial consequences of the loss are transferred from the insured to the insurer. Other examples of this type of risk transfer are disclaimers and hold harmless agreements.

An example of the second type of risk transfer, in which the activity itself is transferred to another party. For example: a tour company electing to contract with a bus company for transport of its clients. Rather than use its own buses, which might be in disrepair, a portion of the risk is transferred to the bus company. Of course, this scenario might bring about contingent liability if, for example, the tour operator was negligent in failing to determine that the bus company was properly insured.

The main objective of any transfer should be to place the financial responsibility with the party which has the most control over the activity, or with an insurer who is familiar with the risk.

Planned Retention - The last category of exposure treatment is planned retention. Note the emphasis on planned! Unconscious retention results when the Risk Management process has failed to identify a loss exposure. Because not all losses can be avoided by using loss control measures, insurance, or risk transfers, retention will consequently affect all companies. The focus, then should be on determining how much of a retention level can be absorbed. This would be governed by the availability of resources to fund the retentions and the limit to which losses can be forecasted.

How is retention accomplished? Two (2) of the most common forms of retention are insurance deductibles and a self-insured retention or *S.I.R*.

A deductible is simply the amount an insured is required to contribute toward a paid claim. The SIR differs from a deductible in that it generally uses Excess Insurance Coverage as the top layer of protection and retains the primary layer. This method is commonly employed by Group Health Insurance programs in which a company retains a certain limit of coverage per employee and maintains an excess Major Medical Policy for the second layer of protection.

Liability exposures are more difficult to forecast than those associated with property. It's virtually impossible to set a limit on the potential liability associated with vehicular accidents (whether owned or non-owned vehicles are involved), premises operations, or the broad array of professional operations and their related exposures. This contrasts with more predictable "maximum possible losses" associated with property exposures.

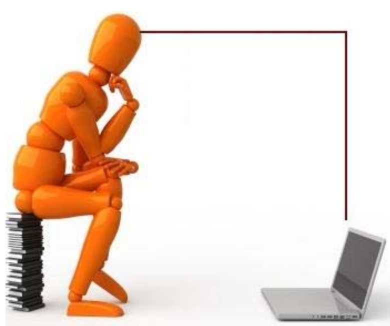
Steps 3 & 4: Evaluating & Monitoring the Selected Treatments

In evaluating which treatments should be used, a company must consider not only the effectiveness of that treatment, keeping in mind which ones are required by law, but the true cost of that treatment. A value should be added for the "peace of mind" which comes from knowing that an exposure will be handled by an insurer in the event of a loss.

The process of evaluating any Risk Management program should be ongoing. Conditions are always changing in any business - fees, products, airfares, client refund procedures, employees, new contracts and leasing agreements... the list is endless! For a Risk Management program to be effective, it must be constantly monitored.

Owners can rely on many resources to help them achieve the ultimate objective of any company - to increase the "bottom line".

Understanding risks and learning how to minimize their impact on the financial well-being of your company should be the ultimate Risk Management objective.



Sources: *Principles of Risk Management and Insurance.,* Vol. I, II. American Institute for Property and Liability Underwriters, 2nd Ed. 1981.