The Total Cost of Insurable Risk

Quantitative approaches to informing your risk/reward decisions

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What is the total cost of insurable risk?

TOTAL COST OF INSURABLE RISK

= RISK TRANSFER COSTS (INSURANCE PREMIUMS) + ACTUAL OR EXPECTED RETAINED LOSSES + EXTERNAL AND INTERNAL RISK MANAGEMENT COSTS
Why use TCOIR?

The Total Cost of Insurable Risk outputs assists an organisation to:

- Understand the overall cost of insurance risk (rather than simply focus on premiums alone)
- Better understand the costs absorbed within the retentions / deductibles
- Benchmark performance year on year and also benchmark against similar industry and / or revenue sized entities
- Make more informed decisions taking into account past experience of loss, risk tolerance and risk appetite
Risk Tolerance & Risk Transfer decisions

Risk Retention Strategy

- Insurers won’t insure or will charge excessive premium
- Earnings, working capital and budgets can usually sustain losses in this range

Risk Transfer Strategy

- Earnings, equity capital and budgets are highly susceptible to losses in this range
- Equity holders may be willing to chance a loss in this range
Understanding Insurable Risk Tolerance

- Insurable Risk is only one component of an organisation’s total risk portfolio.
- The entire risk portfolio must be taken into consideration when making decisions on insurable risk tolerance.
- Risk “Tolerance” and Risk “Appetite” are not the same thing.
By calculating your total cost of insurable risk, you can measure the total value and effectiveness of your risk management expenditure over time.
TCOIR as a key performance indicator ...

- Insurance premiums reflect the risk level of the organisation – the underlying risk profile of the organisation and it’s risk exposure (the financial value of the risk transferred)

- Retained losses reflect the level of losses that could have been covered by insurance but accepted or retained by the organisation (the financial value of risks retained by reason of management decisions)

- Risk management costs reflect the organisation’s level of activity undertaken to avoid or eliminate risk exposures plus the cost of managing and treating exposure to risk (the financial value of risk management activity)
Benefits of TCOIR for Agencies

- TCOIR benchmarks your Risk Management performance
- Benchmarks against other agencies of similar industry
- Finally it is a common KPI to benchmark all agencies no matter what their size!
Think risk and reward management

- Identify Risk
  - Reject
    - Exit, Sell, Outsource
  - Accept
    - Optimise risk reward return
    - ‘Invest’ in risk controls
      - Arbitrage cost of insurance vs cost of own capital
      - Use insurance beyond risk tolerance & appetite
TCOIR in the Public Sector environment

- The introduction of Comcover in 1998 flagged a major shift to the introduction of risk management principles within the Commonwealth public sector.

- The fact of accrual accounting also demanded a better manner of quantifying and identifying risk.

- The public sector has been undergoing change for some time, accountability is applied at every level and across all service delivery.
Links to Comcover’s Risk Profiling Service

- A systematic way to ensure that the insurable risks of the company are either retained with the full knowledge of the company or transferred to the insurance market – no gaps or overlaps.

- A documented approach that supports the risk financing decisions – good corporate governance.

- Decision support tools to help choose the optimum point of retention and transfer – minimisation of Total Cost of Insurable Risk.
Did you know reputation was considered the biggest risk concern by Australian executives in 2004/05?
Risk Management & Cost of Insurable Risk Survey

The purpose of the survey:

- To identify the dominant business risk issues concerning corporate Australia

- To obtain an understanding of how Australian organisations are profiling, treating and financing risks

- To examine any trends and developments in risk management and insurance

- To provide organisations with the ability to benchmark risk management and risk financing - over time and across similar organisations
What was the number 1 risk concern for Australian organisations in 2005/06?
# 2002-2006 Top 10 Risks Concerns

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<td>Liquidity</td>
<td>Information Management</td>
<td>Lack of innovation</td>
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